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THE SUPERIOR COURT OF THE STATE OF ARIZONA
IN THE ARIZONA TAX COURT

ESTATE OF HELEN H. LADEWIG, on behalf of itself and the class of all persons in the State of Arizona who, during any one of the years 1986 to 1989 paid income taxes to the State of Arizona on dividends paid by corporations whose principal business was not attributable to Arizona, et al., Plaintiffs vs. ARIZONA DEPARTMENT OF REVENUE and its Director, in his official capacity, Defendants.	No. TX 97-00075 DEPARTMENT OF REVENUE'S RESPONSE TO STANDING MOTION AND MOTION IN LIMINE (Assigned to the Hon. Paul A. Katz)

Class Counsel's Motion for an Order Determining the Department's Lack of Standing to Contest Class Counsel's Common Fund Attorneys' Fee Award and Motion in Limine (the "Motion") seeks to prohibit the State of Arizona from commenting in any way on their Motion for Attorneys' Fees Award (the "Fee Motion"). The State does not dispute that Class Counsel is entitled to attorneys' fees in this case. This Court, however, has a fiduciary duty to protect the class members. The ethical rules also require that attorneys' fees be reasonable under the particular facts of the case. See ER 1.5. The State is not here trying to appeal or contest an award determined by this Court. Rather, it

merely intends to present information and arguments to assist the Court in determining an appropriate fee award for the actual work performed for the benefit of the class members in this case.

The Mediation Agreement and Settlement specifically state that the Department may argue the reasonableness of attorneys' fees within the range of nine to twelve percent of the common fund. The Arizona Department of Revenue ("Department") is an aggrieved party under the settlement and is solely responsible for administering the common fund. Therefore, the Department has standing to be heard on the merits of Class Counsel's attorneys' fee request. Moreover, because neither the Court nor the class members were involved in most of the litigation in this case, the State can provide essential information about Class Counsel's legal services that is not readily available to the Court or class members.

I. THE DEPARTMENT HAS THE CONTRACTUAL RIGHT TO ARGUE TO THE COURT REGARDING THE FEE AWARD.

The Department and Class Counsel entered into mediation to help settle this matter. The stumbling block was not the settlement terms themselves. The parties agreed to a refund formula and payment cap prior to the mediation. Rather, the problem stemmed from Class Counsel's insistence that the State had no right to participate in the attorney fee issue and that the settlement could not proceed unless the State waived any rights that it might have to be heard or to appeal an attorney fee award. Through mediation the parties created an agreeable procedure to resolve the attorneys' fee issue. The State and Class Counsel agreed to present their arguments concerning the fee award to the mediator. He would then make a recommendation concerning a reasonable fee range. The State and Class Counsel further agreed that if they accepted the mediator's fee range as reasonable they would submit it to this Court. In that event, the State and Class

Counsel could presents arguments to this Court for an award within that range and could not appeal a fee award within that range.

The parties documented this compromise in an agreement ("Mediation Agreement"), attached hereto as Exhibit A, which provides:

> 5. If the State Defendants find the high end of the range "not to be unreasonable" and Class Counsel find the low end of the range "not to be unreasonable" then the parties will submit the expert's recommendation to the Court with a stipulation that (1) the Court may not approve an attorneys' fee in excess of the upper end of the range, and (2) neither the State Defendants nor any other State office will appeal any order by the Court if it is lower than the upper end of the range, and (3) Class Counsel will not appeal any order by the Court if it is higher than the lower end of the range.
>
> 6. If the stipulation in (5) above is submitted to the Court, **the parties shall be free to argue to the Court for any determination of an attorneys' fee within the range recommended by the expert and shall be free to argue their positions as set forth below.** The following statements of position shall not waive or limit the parties' respective rights to assert those positions to the Court. Class Counsel Position: Class Counsel contends that neither the Office of the Attorney General nor the State Defendants have standing to object to, participate in briefing or contest any request for an award of attorneys' fees by Class Counsel; Class Counsel acknowledges that the State Defendants and the Office of the Attorney General dispute those contentions. Office of the Attorney General Position: The Office of the Attorney General and the State Defendants contend that they have standing to object to, participate in or contest any request for an award of attorneys' fees by Class Counsel; the Office of the Attorney General and the State Defendants acknowledge that Class Counsel disputes those contentions.

Emphasis added. The relevant provisions from the Mediation Agreement were set forth in paragraph 14 of the Stipulation of Settlement (the "Settlement") as follows:

> Class Counsel and the Department stipulate that (1) the Tax Court may not approve an attorneys' fee in excess of the upper range of the recommendation, (2) neither the State Defendants nor any other State

office will appeal the award to Class Counsel as long as it does not exceed the upper range of the recommendation, and (3) Class Counsel will not appeal the award to Class Counsel as long as it does not fall below the lower range of the recommendation. **Class counsel and the Department shall be free to argue to the court for any determination of an attorneys' fee within the range recommended by the neutral expert.** Further, this agreement does not resolve the legal issue of whether the State Defendants have standing to contest any request by Class Counsel for Attorneys' Fees and Costs."

In the absence of fraud, a court must give effect to a contract as it is written, and the terms of a contract, where clear and unambiguous, are conclusive. *Goodman v. Newzona Investment Co.*, 101 Ariz. 470, 472, 421 P.2d 318, 320 (1966). The intent of the parties, as ascertained by the language used, must control the interpretation of the contract. *Id.* Pursuant to the Mediation Agreement and Settlement, Class Counsel's Fee Motion requests an award of twelve percent of the common fund, the high end of the recommended fee range. The State intends to argue that this Court should award a nine percent fee, the low end of the recommended fee range. Both the Mediation Agreement and the Settlement unambiguously provide that the State has the right to do so.

Class Counsel argue that the State's right to be heard on their Fee Motion is contingent on the resolution of the standing issue. The Mediation Agreement and Settlement indicate that the parties did not reach an agreement concerning the State's standing. The State and Class Counsel preserved their respective positions concerning standing, which could be important in the event that this Court awards a fee outside the mediation range, if there is an appeal by a class member, or if there are other class action cases concerning the State and Class Counsel. The terms of the Mediation Agreement and Settlement, however, do not reflect that the State's authority to argue fees within the recommended range is dependent upon the resolution of the standing dispute.

Had the parties intended standing be a prerequisite to the Department's right to be

heard, the terms could have easily reflected that intent. For example, the agreements could have stated that in the event the Court finds that the State has standing, then and only then shall the State be free to argue for an attorneys' fee award within the recommended range. The agreements did not overrule the express agreement to permit the Department to argue fees within the recommended ranges merely by preserving the broader standing arguments.

Class Counsel asserts that Mark Killian's statements on a television show prohibit the State from contesting the Fee Motion or somehow change the contractual terms. (Motion at 4.) This is nothing more than a red herring. The Department's Director, Mark Killian, appeared on "Horizon" to discuss the settlement in this case. Throughout the program, Mr. Killian provided useful information to the public. Near the end of the program the host asked Mr. Killian about the fee request. Mr. Killian chose not to use the question to debate the appropriateness of a particular fee in the media. Instead, he merely stated that the upper limit of the range, twelve percent, was fair. That statement is consistent with the Mediation Agreement, contemplating that, if the State found the upper limit of the range not unreasonable and Class Counsel found the lower limit of the range not unreasonable that the parties would incorporate language from the Mediation Agreement in the Settlement and submit the recommendation to the Court. Mr. Killian intended to remain professional and work toward a resolution in this matter. He intended to support the fee range recommended by the mediator. He did not intend to waive or contradict the Department's position that the fee award in this case should be at the lower end of the recommended range, but wanted that to be handled in Court. *See* Declaration of Mark Killian attached hereto as Exhibit B.

Mr. Killian's statements are no more an admission that the Court should award a twelve percent fee than Class Counsel's agreement in the Mediation Agreement are an

admission that this Court should award a nine percent fee. The fact that the mediation process resulted in a fee range, not a single agreeable amount, reflects the remaining good faith dispute between the parties. *Cf. James Cooke & Hobson, Inc. v. Lake Havasu Plumbing & Fire Protection*, 177 Ariz. 316, 868 P.2d 329 (holding that an attorney cannot deny an allegation in the complaint without any good faith basis merely to put the plaintiff to its proof). The Department has a good faith belief that a fee award of nine percent is more appropriate than the twelve percent that Class Counsel request.[1]

The Mediation Agreement and Settlement reflect a compromise between the State and Class Counsel. The State wanted to leave the entire issue to the courts, and was willing to abide by the courts' decisions. Class Counsel wanted the certainty that the State would not appeal a fee award. As a compromise the State gave up its potential rights to appeal an award in exchange for the certainty that that it would have the ability to argue for an award within a certain range to this Court. This Court should enforce the parties' agreement and reject Class Counsel's attempt to prohibit the State's opposition.

II. THE DEPARTMENT HAS LEGAL STANDING TO CONTEST CLASS COUNSEL'S REQUEST FOR ATTORNEYS' FEES IN THIS CASE.

The Department is a party to the Settlement and has standing to contest the attorneys' fees administered and paid pursuant to the Settlement. A party's standing turns on whether it is aggrieved by the settlement. *Kerr v. Killian,* 197 Ariz. 213, 216, 3 P.3d 1133, 1136 (App. 2000). In *Kerr,* the Department appealed the fee award on the grounds that common fund award was inappropriate in that case, that the award violated the class members' due process rights, and that the fees were unreasonable. The taxpayers filed a

[1] This belief is based in part of Mr. Meyerson's estimated lodestar fees of $1.5 million. If the common fund is $350 million, a nine percent award would equate to a 21 multiplier and a rate of over $5,000 per hour. A twelve percent award would equate to a 28 multiplier and a rate of $7,000 per hour.

motion to dismiss the appeal, contending that the award did not aggrieve the Department. *Id.* at 216, 3 P.3d at 1140. The court held that the Department had demonstrated that it was aggrieved by the judgment. The court did not dismiss the appeal, but rather considered the Department's arguments, including the reasonableness of the fee award, and found that the fee was reasonable. *Id.* at 220, 3 P.3d at 1144.

In the instant case, the Settlement imposes significant responsibilities on the Department. The Department will administer the common fund; will provide notices to the class members; obtain all necessary information; calculate the refunds; work with class members to resolve disputes; calculate and account for the reserves; adjust interest calculations as necessary; make the payments to class members and Class Counsel; process undeliverable refunds; and provide periodic reports. As in *Kerr*, the Department is "aggrieved" by the judgment. Class Counsel does not dispute that fact. (Motion at 11.)

As a separate matter, the court in *Kerr* held that the Department lacked standing to challenge the award on the basis of the taxpayers' due process rights "because the right to due process asserted does not belong to the Department." *Id.* at 217, 3 P.3d at 1141. Class Counsel stress this portion of the *Kerr* decision. (Motion at 11-12.) The due process argument in *Kerr* was based on the fact that the taxpayers were never parties to the legal action. In this case, however, the class members are parties and the State is not trying to protect the due process rights of class members. The only issue is the reasonableness of the fee requested. In *Kerr*, the Department's lack of standing to assert the due process rights of non-party taxpayers did not hinder the Department's standing to assert its own rights. Both the tax court and the court of appeals permitted the Department to object to the reasonableness of the fee award. That case does not support Class Counsel's contention that the State cannot even respond to a multi-million dollar fee request in a case in which it is a party.

A number of courts outside Arizona also acknowledge that an administrative burden or other continuing interest of a defendant in a class action common fund case will give rise to standing to contest class counsel attorney fees. *See e.g. Chun v. Board of Trustees of the Employer's Ret. Sys. of the State of Hawaii,* 92 Hawaii 432, 992 P.2d 127 (2000). In *Chun*, the plaintiffs argued that the Employer's Retirement System ("ERS") lacked standing to challenge and criticize the amount of attorneys' fees that class counsel requested. *Id.* at 440, 992 P.2d at 135. The court disagreed. *Id.* Instead, the court held that the ERS's administrative responsibility to deduct the attorney's fees from the class members' payments gave it standing to challenge the attorney fee award. *Id. See also, Allen v. U. S.*, 606 F.2d 432 (4th Cir. 1979) (Government had standing to contest the fee awards, even though the award was not to be assessed against the government and government has an interest in seeing that funds it owes to litigants are disbursed properly.); *Freeman v. Ryan*, 408 F.2d 1204 (D.C. Cir. 1968) (Where litigation involving federal programs comes to involve questions of attorney's fees the cognizant federal official has an interest in the fee award even the fee does not decrease funds in the Treasury.)

The court in *Chun* also distinguished many of the cases upon which Class Counsel rely, such as *Boeing Co. v. Van Gemert,* 444 U.S. 472 (1980) and *Copeland v. Marshall,* 641 F.2d 880 (D.C. Cir. 1980). In those cases, the judgment stripped the defendant of any continuing interest in the fund. Here, as in *Chun*, the Department is primarily responsible for administering the fund, calculating the payments to class members, and calculating and paying the awarded attorneys' fees. *See Chun*, 92 Hawaii at 440-41, 992 P.2d at 135-36.

Class Counsel also erroneously rely on *Bailey v. State of North Carolina,* 540 S.E. 2d 313 (2000). (Motion at 12-14.) In *Bailey*, as Class Counsel acknowledge (Motion at

13), the trial court did not grant class counsel's motion to exclude the North Carolina Attorney General from the fee proceedings. North Carolina then tried to appeal the fee issue. The North Carolina Supreme Court denied the State's standing in part because the State had waived any rights to be heard concerning attorney fees, costs or administration expenses in the settlement agreement. *Id.* at 318-319. The State also was not responsible for administering the settlement.

The instant case is completely dissimilar to the *Bailey* facts. The Department will maintain a continuing ownership interest in the monies to be paid in settlement, and will retain responsibility for settlement administration as described above. Further, the Department has not waived its standing to challenge the common fund fee award, a critical fact in the denial of standing in *Bailey*.

Class Counsel assert that even if the Department has standing to object to the fee award, the ethical rules prohibit its counsel from being heard under any circumstances. (Motion at 15-16.) This is allegedly based on an argument that the State is trying to control the payment of Class Counsel's fees and expenses. (Motion at 17.) Class Counsel's assertions are not supported by the facts of this case. The Department has always agreed that Class Counsel are entitled to a reasonable fee award. Indeed, the Settlement provides for the advance of millions of dollars in fees. Settlement, ¶ 14. The Department has never sought to make the Settlement with class members contingent on the amount of the fee award or entered into secret agreements concerning attorneys' fees. *Cf. Matter of Fee*, 182 Ariz. 597, 898 P.2d 975 (1995) (noting that class counsel reached a separate agreement to be paid greater fees than those which the court awarded). The Department does not seek to control the fee award. This Court will grant a fee award that it believes is fair and reasonable under the circumstances regardless of whether the State agrees with the award. Contrary to Class Counsel's assertions, the Motion does not

concern Class Counsel's ability to represent their clients. Rather, it demonstrates that Class Counsel are trying to prohibit all knowledgeable comments on to their Fee Motion.

Class Counsel fail to acknowledge that their Fee Motion is intended to benefit themselves, not the class members. Courts have recognized, however, that in pursuing fee awards, class counsel's role changes from one of fiduciary for the class to claimant against the client's fund created for the client's benefit. *Kuhnlein v. Department of Revenue*, 662 So. 2d 309, 311 (Fla., 1995). Indeed, it is because the relationship between plaintiffs and their attorneys turns adversarial at the fee-setting stage that courts have stressed that they "must assume the role of fiduciary for the class plaintiffs." *Vizcaino v. Microsoft Corporation*, 290 F.3d 1043, 1052 (9th Cir, 2002).

The court in *Kuhnlein* held that the State has an interest in protecting its citizens from excessive fees or costs which would diminish the amount of the tax refund they are entitled to receive from the common fund in this case. *Kuhnlein* 662 So. 2d at 311. The State has an interest in assuring the integrity of the settlement for the benefit of its citizens who are members of the class and for others whose taxes ultimately pay the refund. This interest applies for all citizens who depend on the State for the responsible administration of State resources. To this extent, the Department's interest in the amount of fees to be awarded from settlement funds is sufficient to provide an adequate basis for standing.

III. IN THE ALTERNATIVE, THE COURT SHOULD AUTHORIZE THE STATE TO PARTICIPATE IN THE FEE AWARD PROCEEDINGS AS AN *AMICUS CURIAE*.

This Court has a fiduciary responsibility to ensure that any fee award is fair and reasonable under the facts of this case. *In re Washington Pub. Power Supply Sys. Sec. Litig.*, ("WPPSSS")19 F.3d 1291, 1296 (9th Cir. 1994). Courts guard against the perception that attorneys' fees reward enterprising attorneys at the expense of class

members. *City of Detroit v. Grinnell Corp.*, 560 F.2d 1093, 1098 (2nd Cir. 1977). This Court cannot comply with this duty if it does not have full and complete information.

Class Counsel claim that "the Department (or its attorneys) are pursuing an improper ulterior motive." (Motion at 5.) Class Counsel assert that the State has "a vested interest in keeping the award as low as possible." (Motion at 8.) Indeed the Motion is premised almost entirely on Class Counsel's mistaken belief that the State is out to get them. The State, however, is trying to protect the integrity of the judiciary and the legal profession. The interests of justice are best served by allowing the State to present the counterbalance to Class Counsel's arguments. Furthermore, the State has information that is not readily available to anyone else. The following are some examples of this.

Class members do not have full knowledge of the 12 year procedural history in this case. They do not have ready access to the files and cannot in the short time provided to object to the Fee Motion adequately understand the nature of the legal action taken before the Hearing Office, Board of Tax Appeals, Tax Court, Court of Appeals and Supreme Court proceedings in this case.[2] Even a review of the pleading index for each proceeding would be time consuming and such a review would not provide necessary information. For example, Class Counsel have claimed that they were sanctioned for filing the original tax court action, but were eventually vindicated. Class Counsel actually filed a four count complaint. Counts I, II and IV sought relief under 42 U.S.C. § 1983 against the Director

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[2] Class Counsel note that the attorneys who initially handled this matter have since left the Attorney General's Office. (Motion at 16, n.5.) They did not, however, take the files with them. Therefore, the State has access to information that this Court and the class members could not easily obtain. Moreover, the attorneys currently handling this case have already spent a great deal of time familiarizing themselves with the history and pertinent facts of this case. They thus have special knowledge that could assist this Court.

of the Department and his wife and the Assistant Director of the Department, in their official and individual capacities for administering the laws as written. Only Count III sought an income tax refund from the Department and the State of Arizona. The court awarded attorneys fees to the State with respect to Counts I, II and IV, but not with respect to Count III. The court entered judgment in favor of the Department, but later vacated the judgment because it lacked jurisdiction because the plaintiff had failed to exhaust its administrative remedies. Class Counsel then abandoned its frivolous 1983 claims.

Class members also lack information about the settlement procedure. While the Department and its attorneys participated extensively in the settlement process, class members did not even know about the case, much less participate in the settlement negotiations. The State's information concerning the settlement negotiations could assist the Court. For example, Class Counsel claim to have engaged in extensive document review in deriving the settlement formula. The State can demonstrate, however, that Class Counsel merely reviewed the Department's statistical information. Class Counsel do not have the class members' tax returns and could not conduct their own analysis of the dividends income that they reported because that information is confidential. Class Counsel also suggests that they will have to vigorously contest the Department's actions in the future. (Motion at 8.) The State can help explain the limited scope of any future objections under the Settlement.

The State also has investigated the facts surrounding various fee awards by other courts. For example, in the mediation Class Counsel submitted an affidavit indicating that the court awarded class counsel fifteen percent of the common fund in *Bailey*, eleven percent for fee and four percent for costs. This affidavit is attached hereto as Exhibit C. The reported court decision merely notes that the parties reserved fifteen percent for a fee

award. *Bailey*, 353 N.C. 142, 540 S.E.2d 313 (N.C. 2000). The Department obtained the pleadings and orders in that case. The trial court actually granted an attorneys' fee award of 8% of the common fund. A copy of the court's March 2000 fee order in *Bailey* is attached hereto as Exhibit D. The court later granted class counsel and additional 1% as the final fee award based on the fact that class counsel had worked to obtain a favorable ruling from the North Carolina Supreme Court concerning the accrual of interest on the settlement fund, which protected the accrual of approximately $85 million in interest on payments to the class members. A copy of the final fee order is attached hereto as Exhibit E. These orders are not readily available in Arizona.[3]

Class Counsel assert that it is ludicrous to think that this Court may want to hear from the State in determining reasonable attorneys' fees. (Motion at 2.) This Court, however, has personal knowledge of a very small portion of Class Counsel's services in this case. This Court does not have the ability to investigate every statement made in the support of the Fee Motion. Indeed, without the State's participation, the Court will likely only know what Class Counsel choose to present. The Court has a significant responsibility to act as a fiduciary for the class members. This Court is best served by allowing the parties to present opposing arguments and information. If Class Counsel are confident that their Fee Motion is appropriate, they should not fear an opposing argument by the State.

Class Counsel originally requested fees in the range within 22.5% to 29.5% of the common fund. That request could have totaled between $78,750,000 and $103,250,000. Mr. Meyerson recommended a range between nine and twelve percent. Class Counsel seeks to present the same arguments that they made to Mr. Meyerson while prohibiting

[3]The fee award in *Bailey* is especially important because it involved a large tax refund. Thus, that case bears greater similarity to this case than any other large class action case.

the State from presenting the counterbalancing arguments. In addition, Class Counsel wants this Court to ignore *Schweiger v. China Doll Restaurant, Inc.*, 138 Ariz. 183, 673 P.2d 927 (App. 1983), *Viscaino*, and *WPPSS* and ER 1.5, all of which discuss the consideration of time and labor in determining reasonable attorney fees. This Court, however, cannot adequately consider the fee request or Mr. Meyerson's recommendation without having access to the information and arguments presented to Mr. Meyerson and other information that this Court may need. Therefore, the Court should, at the very least, permit the State to appear as *amicus curiae* to keep the fee proceedings balanced.

IV. THIS COURT SHOULD STRIKE THE ATTACHMENTS TO THE MOTION BECAUSE THEY MERELY SET FORTH UNSUBSTANTIATED LEGAL OPINIONS.

Class Counsel's Motion is twenty-three pages long. Class Counsel then attach three legal opinions to the Motion. These opinions do not present relevant factual information concerning the State's standing. Rather, they merely extend an already lengthy pleading with speculative and irrelevant legal arguments. This Court can analyze the arguments made in the pleadings. It does not need to rely on legal conclusions set forth in letters and declarations.

A. The Zlaket Letter Merely Speculates about the Department's Motivation.

Former Chief Justice Thomas Zlaket claims that he does not understand why the Department wants to take a position concerning Class Counsel's attorneys' fees, but goes on to offer several suggestions based on speculations concerning the State's motives.

Mr.Zlacket's letter suggests that if his speculations were true, the State's actions could violate various ethical rules. The State's counsel does not violate any of these rules merely by objecting to Class Counsel's $42 million fee request. For example, the letter mentions E.R. 1.7 (conflict of interest). There is no conflict of interest in pursuing the

State's interest to make sure that the fee award is reasonable and supported by the facts of this case. See ER 1.5. If there is a conflict, it is between Class Counsel and the class members on the issue of fees. Similarly, the letter cites E.R. 2.1 (independent professional judgment) and E.R. 5.4 (professional independence). Again, the State is not trying to preclude Class Counsel from obtaining a fair and reasonable fee for their services or to preclude Class Counsel from adequately representing the class members. Rather, the issue is whether this Court should award Class Counsel $31.5 million or $42 million. Such a dispute does not interfere with Class Counsel's professional independence.

B. The Silver Declaration Sets Forth a Legal Position that Contradicts Arizona and 9th Circuit Law as well as Bruce Meyerson's Recommendation.

The Silver Declaration presents over twenty pages of arguments against using any lodestar information in calculating attorneys' fees in class actions. That argument is not only contrary to the law, but it also does not address the standing issue.[4] Therefore, the declaration is irrelevant.

Moreover, Mr. Silver asserts the importance of minimizing any conflicts between counsel and class members and minimizes the importance of protecting against the appearance of excessive fee awards. Professor Silver believes that State Bar Ethics have little place in determining reasonable attorneys' fees in class actions.

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[4] The Department set forth the significant body of law supporting the use of time records as either the primary basis for fee awards, or alternatively as a cross-check on the reasonableness of a percentage fee award. Class Counsel has already argued that it should not have to present its records. Mr. Meyerson considered this issue and determined that time records were important. This Court has also indicated that Class Counsel will have to submit its time records.

> Fees in class actions have nothing to do with legal ethics and are not governed by ethical principles. . . . If such a fee is inconsistent with the state bar ethics rules that limit fees to a reasonable amount, I say too bad for them. . . . My point is simple. Judges should also ignore the fee rules. They should set fees in class actions with an eye to maximizing the net recovery of class members and they should not care one whit about the criteria that state bars have adopted.

Conference on Excessive Legal Fees: Protecting Unsophisticated Consumers, Class Action Members, and Taxpayers, Panel Three: Fees in High Stakes Litigation: Class Actions and Suits by Government Agencies, Comprehensive edited transcript of conference, pp. 57-58, Manhattan Institute Conference Series, May 25, 2000. (http://www.manhattan-institute.org/html/mics3a.htm)(Selected portions attached as Exhibit F.) Professor Silver's opinion is not widely accepted. For example, Michael Horowitz, Director of the Project for Civil Justice Reform at the Hudson Institute, countered Professor Silver's remarks by describing the fee debate as one where there is "the rhetoric of ethical regulation and fiduciary duty, and the reality, thanks in part to Charlie's efforts, to an almost complete (and increasing) real-world breakdown of enforceable ethical norms." Id at p. 63.

C. Class Counsel Should Not Supplement Its Pleading with its Own Declaration.

Finally, Class Counsel attaches Randall Wilkins' seven page declaration. The declaration contains legal and factual arguments and opinions. Class Counsel cannot transform their own opinions into absolute facts merely by setting them out in a declaration.

V. CONCLUSION

For the above reasons, the Department asks this Court to allow it to be heard on the issue of reasonable attorney fees and deny Class Counsel's Motion.

RESPECTFULLY SUBMITTED this 15th day of November, 2002.

JANET NAPOLITANO
Arizona Attorney General

Michael F. Kempner
Assistant Attorney General

Copy hand delivered this 15th day of November, 2002 to:

Honorable Paul A. Katz
Judge of the Arizona Tax Court
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and

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TAX94-0390
#379784 v4 - LADEWIG RESPONSE II

EXHIBIT A

MEDIATION PROCESS FOR RESOLUTION OF ATTORNEYS' FEES CLAIM IN ESTATE OF LADEWIG v. ARIZONA DEPARTMENT OF REVENUE

1. Class Counsel and the Arizona Department of Revenue and its Director, (the "State Defendants"),(collectively the "Parties") agree that Class Counsel is entitled to a reasonable attorneys' fee for their efforts in this matter.
2. The Parties have agreed to a process to facilitate a determination by the Court of a reasonable fee for the purpose of seeking to avoid further litigation, disputes and expenses over the determination of Class Counsel's fee.
3. The first step in the process will be for the Parties to obtain the recommendation of Bruce Meyerson as a neutral expert. That will involve the following:
    a. By August 15, 2002, class counsel will submit to the neutral expert and to the Office of the Attorney General material setting forth a recommended fee. Class counsel may submit an affidavit regarding fee awards in comparable cases. If authorities are cited in that affidavit they shall be capable of verification, or if not readily verifiable, copies of such authorities shall be submitted.
    b. By August 27, 2002, the Office of the Attorney General, on behalf of the State Defendants, will submit to the neutral expert and Class Counsel its recommended fee. In submitting its recommendation, the Office of the Attorney General may submit argument regarding the time that it has devoted to its representation in this matter.
    c. A meeting will be held among the parties and the neutral expert promptly thereafter to further discuss the parties' recommendations.
    d. Within one week following such meeting the neutral expert shall make a confidential recommendation to Class Counsel and the State Defendants of a range that would apply to the determination of a reasonable attorneys' fee. It has been represented that in this case, Class Counsel will remain involved in the administration of the distribution of funds over a several year period. The neutral expert is aware of this, although the parties will not make argument to the neutral expert regarding this issue. The Parties are free to argue this issue to the Court as provided for in and subject to (6) below.
4. Upon receipt of the recommendation, the Parties will have five working days within which to consider the recommendation.
5. If the State Defendants find the high end of the range "not to be unreasonable" and Class Counsel find the low end of the range "not to be unreasonable" then the parties will submit the expert's recommendation to the Court with a stipulation that (1) the Court may not approve an attorneys' fee in excess of the upper end of the range, and (2) neither the State Defendants nor any other State office will appeal any order by the Court if it is lower than the upper end of the range, and (3) Class Counsel will not appeal any order by the Court if it is higher than the lower end of the range.

6. If the stipulation in (5) above is submitted to the Court, the parties shall be free to argue to the Court for any determination of an attorneys' fee within the range recommended by the expert and shall be free to argue their positions as set forth below. The following statements of position shall not waive or limit the parties' respective rights to assert those positions to the Court. Class Counsel Position: Class Counsel contends that neither the Office of the Attorney General nor the State Defendants have standing to object to, participate in briefing or contest any request for an award of attorneys' fees by Class Counsel; Class Counsel acknowledges that the State Defendants and the Office of the Attorney General dispute those contentions. Office of the Attorney General Position: The Office of the Attorney General and the State Defendants contend that they have standing to object to, participate in or contest any request for an award of attorneys' fees by Class Counsel; the Office of the Attorney General and the State Defendants acknowledge that Class Counsel disputes those contentions.
7. Except as expressly provided for herein, nothing in this agreement shall be binding upon the Court or others not a party to this agreement.
8. A draft of the Stipulation of Settlement in this case was forwarded to Class Counsel on July 30, 2002. The obligations arising out of this mediation agreement shall be contingent upon the completion and final execution of the terms of the Stipulation of Settlement as contained in the July 30 draft subject to typographical corrections, revisions to paragraph 14 (Attorney Fees and Costs) and calculations of applicable dates. In the event that the Stipulation of Settlement is not finally executed by the parties and approved by the Court, this mediation agreement shall be of no force and effect and shall not be binding upon the parties.

DATED this 7 day of August, 2002.

_____
Class Counsel

_____
Arizona Department of Revenue
By: Mark W. Killian, Director of Revenue

MEDIATION PROCESS FOR RESOLUTION OF ATTORNEYS' FEES CLAIM IN ESTATE OF LADEWIG v. ARIZONA DEPARTMENT OF REVENUE

1. Class Counsel and the Arizona Department of Revenue and its Director, (the "State Defendants"),(collectively the "Parties") agree that Class Counsel is entitled to a reasonable attorneys' fee for their efforts in this matter.
2. The Parties have agreed to a process to facilitate a determination by the Court of a reasonable fee for the purpose of seeking to avoid further litigation, disputes and expenses over the determination of Class Counsel's fee.
3. The first step in the process will be for the Parties to obtain the recommendation of Bruce Meyerson as a neutral expert. That will involve the following:
    a. By August 15, 2002, class counsel will submit to the neutral expert and to the Office of the Attorney General material setting forth a recommended fee. Class counsel may submit an affidavit regarding fee awards in comparable cases. If authorities are cited in that affidavit they shall be capable of verification, or if not readily verifiable, copies of such authorities shall be submitted.
    b. By August 27, 2002, the Office of the Attorney General, on behalf of the State Defendants, will submit to the neutral expert and Class Counsel its recommended fee. In submitting its recommendation, the Office of the Attorney General may submit argument regarding the time that it has devoted to its representation in this matter.
    c. A meeting will be held among the parties and the neutral expert promptly thereafter to further discuss the parties' recommendations.
    d. Within one week following such meeting the neutral expert shall make a confidential recommendation to Class Counsel and the State Defendants of a range that would apply to the determination of a reasonable attorneys' fee. It has been represented that in this case, Class Counsel will remain involved in the administration of the distribution of funds over a several year period. The neutral expert is aware of this, although the parties will not make argument to the neutral expert regarding this issue. The Parties are free to argue this issue to the Court as provided for in and subject to (6) below.
4. Upon receipt of the recommendation, the Parties will have five working days within which to consider the recommendation.
5. If the State Defendants find the high end of the range "not to be unreasonable" and Class Counsel find the low end of the range "not to be unreasonable" then the parties will submit the expert's recommendation to the Court with a stipulation that (1) the Court may not approve an attorneys' fee in excess of the upper end of the range, and (2) neither the State Defendants nor any other State office will appeal any order by the Court if it is lower than the upper end of the range, and (3) Class Counsel will not appeal any order by the Court if it is higher than the lower end of the range.

6. If the stipulation in (5) above is submitted to the Court, the parties shall be free to argue to the Court for any determination of an attorneys' fee within the range recommended by the expert and shall be free to argue their positions as set forth below. The following statements of position shall not waive or limit the parties' respective rights to assert those positions to the Court. Class Counsel Position: Class Counsel contends that neither the Office of the Attorney General nor the State Defendants have standing to object to, participate in briefing or contest any request for an award of attorneys' fees by Class Counsel; Class Counsel acknowledges that the State Defendants and the Office of the Attorney General dispute those contentions. Office of the Attorney General Position: The Office of the Attorney General and the State Defendants contend that they have standing to object to, participate in or contest any request for an award of attorneys' fees by Class Counsel; the Office of the Attorney General and the State Defendants acknowledge that Class Counsel disputes those contentions.
7. Except as expressly provided for herein, nothing in this agreement shall be binding upon the Court or others not a party to this agreement.
8. A draft of the Stipulation of Settlement in this case was forwarded to Class Counsel on July 30, 2002. The obligations arising out of this mediation agreement shall be contingent upon the completion and final execution of the terms of the Stipulation of Settlement as contained in the July 30 draft subject to typographical corrections, revisions to paragraph 14 (Attorney Fees and Costs) and calculations of applicable dates. In the event that the Stipulation of Settlement is not finally executed by the parties and approved by the Court, this mediation agreement shall be of no force and effect and shall not be binding upon the parties.

DATED this ___ day of August, 2002.

Ronald D. Dilkin 8-7-02
Class Counsel

Arizona Department of Revenue
By: _____

EXHIBIT B

DECLARATION OF MARK KILLIAN

I, Mark Killian, do hereby declare under penalty of perjury as follows:

1. I am the Director of the Arizona Department of Revenue.

2. KAET Television's Horizon television program asked me to appear to discuss the Ladewig refund program.

3. In the past I had been publicly critical of large attorney fees by plaintiff attorneys in class actions and similar matters. My Chief Tax Advocate, Stephen Shiffrin, suggested that for this appearance I should focus on explaining and supporting the settlement and not debate the merits of the attorneys' fee request.

4. During the Horizon appearance the host questioned the amount of attorneys' fees. I intended to say that the 9-12% fee range recommended by Mr. Meyerson was fair. I inadvertently, however, only mentioned the high end of the range. My intent was not to debate the reasonableness of an attorney fee percentage in the media, but to let our attorneys do that in the courts.

5. Prior to the Horizon appearance, the Department reviewed information concerning the attorneys' fee issue. Based on that information I believe that a 9% attorneys' fee award is appropriate. Nothing I said on Horizon changes that belief.

I declare under penalty of perjury that the foregoing is true and correct.

DATED this 12th day of November, 2002.

MARK KILLIAN

380466v1

EXHIBIT C

Paul V. Bonn, State Bar No. 001516
Randall D. Wilkins, State Bar No. 009350
D. Michael Hall, State Bar No. 010267
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Attorneys for Plaintiffs

IN THE SUPERIOR COURT OF THE STATE OF ARIZONA

IN AND FOR THE COUNTY OF MARICOPA

ESTATE OF HELEN H. LADEWIG, on behalf of itself and the class of all persons in the State of Arizona who, during any one of the years 1986 to 1989 paid income taxes to the State of Arizona on dividends paid by corporations whose principal business was not attributable to Arizona, et al., Plaintiffs vs. ARIZONA DEPARTMENT OF REVENUE and its Director, in his official capacity, Defendants.	No. TX 97-00075 DECLARATION OF G. EUGENE BOYCE (Assigned to the Honorable Paul A. Katz)

I, G. EUGENE BOYCE, hereby declare as follows:

1. I served as lead class counsel in the case of *Bailey v. State*, 348 N.C. 130, 500 S.E.2d 54 (1998).

2. Upon remand from the Supreme Court of North Carolina, the *Bailey* case was settled for common fund payments from the State of North Carolina totaling $799 Million.

3. Class counsel in the *Bailey* case received a total award of 15% of the common fund, which represented approximately 11% for Attorneys' Fees and 4% for Costs and Costs

of Administration in connection with the settlement installment payout to class members.

4. Eugene O. Duffy, one of the Class Counsel in this case, was an expert witness in the fairness hearing regarding the adequacy of the settlement and the reasonableness of the award for Attorneys' Fees and Costs in the *Bailey* case. The Court in *Bailey* recognized and relied upon the expert opinion of Mr. Duffy.

5. I declare under penalty of perjury that the foregoing is true and correct.

DATED this 8th day of August, 2002.

G. Eugene Boyce

G. Eugene Boyce

Sworn to and subscribed before me this the 8th day of August, 2002.

Shelia L. Jones

Notary Public

SHELIA L. JONES
NOTARY PUBLIC
WAKE COUNTY, N.C.
My Commission Expires 4/17/04

My commission expires: 4-17-04

EXHIBIT D

NORTH CAROLINA WAKE COUNTY	IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION
BAILEY, et al., v. STATE OF NORTH CAROLINA, et al.	File Nos. 92 CVS 10221, 94 CVS 6904, 95 CVS 6625, 95 CVS 8230
EMORY, et al., v. STATE OF NORTH CAROLINA, et al.	File No. 98 CVS 0738
PATTON, et al., v. STATE OF NORTH CAROLINA, et al.	File No. 95 CVS 04346

MEMORANDUM AND ORDER ON APPLICATION FOR ASSESSMENT OF ATTORNEY FEES AND COSTS

THIS MATTER CAME ON TO BE HEARD before the undersigned Resident Superior Court Judge to whom these consolidated matters were assigned as exoeptional cases by the North Carolina Supreme Court, upon Class Counsel's *Application for Assessment of Attorney Fees and Costs* filed July 13, 1998 ("Fee Petition"), with supplemental petitions and supporting briefs thereafter filed.

The Court has considered all relevant evidence and statements of interested persons with respect to the question of attorneys' fees and expenses, including documents and orders; written and oral statements of Class Members, Class Member organizations, Class Counsel and the Attorney General; opinions of appellate courts; the report of a Referee appointed by the Court to investigate, analyze and summarize the billing records of Class Counsel and co-counsel; and evidence presented by all interested parties.

Following the filing of the Fee Petition, Class Counsel and the Attorney General's Office have filed extensive briefs citing numerous authorities with respect to the determination of reasonable attorneys' fees in "common fund" cases which the Court has considered in addition to the arguments of counsel in open court.

In addition to orders and documents filed in these consolidated cases, the Court has reviewed fee awards in other North Carolina common fund class actions. The Court has also reviewed fee awards in similar-size common fund class actions throughout the United States.

This Court has been involved, and has been able to observe Class Counsel, in all phases of this litigation from pre-trial motions and discovery, through a two-week trial in 1995, and following remand from the North Carolina Supreme Court. This Court, therefore, is well-positioned to consider the circumstances relevant to a determination of a reasonable fee.

PUBLIC POLICY AND ATTORNEYS' FEES IN CLASS ACTIONS

In determining attorneys' fees, the Court is guided by two public policy considerations which, often at odds with one another, are in harmony in this litigation. First, a court award of attorneys' fees must be made with the impact on the credibility of the judicial system and the legal profession in mind. Although a court should never follow public opinion polls, it is appropriate for the court to ensure that any fee award in a common fund case reflects the benefit to class members derived from the efforts of class counsel in a way that treats class members and class counsel equitably. When class counsel gain little benefit for class members, a court should correspondingly limit the attorney fee recovery from the common fund. On the other hand, when class members receive a significant benefit which they would not have received but for the efforts of class counsel, it is appropriate to set a fee award recognizing the benefit to class members.

Second, public policy encourages lawyers to take contingency fee cases. Citizens of this State should be encouraged to challenge the State when it acts illegally or unconstitutionally. Minimizing attorneys' fees in this litigation would chill future challenges to State action generally. As the Supreme Court of Washington noted in *Bowles v. Washington Department of Retirement Systems*, 121 Wash. 2d 52, 847 P.2d 440 (1993) (en banc), "When attorney fees are available to prevailing class action plaintiffs, plaintiffs will have less difficulty obtaining counsel and greater access to the judicial system. Little good comes from a system where justice is available only to those who can afford its price." 121 Wash.2d at 71, 847 P. 2d at 450. This is particularly so when the public interest involves complicated constitutional and factual claims. The public in general and Class Members in this litigation in particular have a direct interest in the continued availability of competent and persistent counsel who will take on litigation against powerful and well-represented adversaries, including the State, in the future.

In these consolidated cases, both public policy considerations fully support the Court's determination. The award appropriately reflects the difficulty of the case, the risk undertaken by counsel, the skill brought to bear, and the success obtained. Class Counsel have literally turned the "sow's ear into a silk purse" on behalf of Class Members. The award to Class Counsel in light of the risk and result in this litigation will further important North Carolina public policy and demonstrate the type of representation and results which should be the goal of every class action.

COMMON FUND DOCTRINE

Attorneys' fees and related litigation expenses are allowed in cases such as the consolidated cases before the Court under the "common fund doctrine," recognized throughout the United States as well as North Carolina. The Court may exercise its sound discretion and award reasonable

attorneys' fees from the common fund recovered. A court should apportion the common fund between the class and counsel in a way "that rewards counsel for success and penalizes it for failure." *In re General Motors Corp. Pick-Up Truck Fuel Tank Products Liability Litigation*, 55 F.3d 768, 821 (3d Cir. 1995), *cert. denied*, 516 U.S. 824, 116 S.Ct. 88, 133 L.Ed.2d 45 (1995). Determination of the exact amount of attorneys' fees to award can be difficult but that decision boils down to what a court considers to be "reasonable."

The "common fund doctrine," first articulated by the United States Supreme Court more than a century ago, has been followed consistently by the Supreme Court of North Carolina beginning in *Horner v. Chamber of Commerce*, 236 N.C. 96, 72 S.E.2d 21 (1952), and most recently in *Faulkenbury v. Teachers' and State Employees' Retirement System of North Carolina*, 345 N.C. 683, 483 S.E.2d 422 (1997), and in *Bailey v. State of North Carolina*, 348 N.C. 130, 500 S.E.2d 54 (1998). The common fund doctrine provides courts the means to ensure that those benefitting from the efforts of counsel pay for those efforts out of the fund created, protected or enlarged by counsel.

Under the common fund doctrine, once a common fund is identified, the Court must determine appropriate attorneys' fees to be paid from that fund. As noted by the North Carolina Supreme Court, paying attorneys' fees is part and parcel of the right of class members to share in the recovery:

> Unless absentees contribute to the payment of attorney's fees incurred on their behalves, they will pay nothing for the creation of the fund and their representatives may bear additional costs. The judgment entered . . . rectifies this inequity by requiring every member of the class to share attorney's fees to the same extent that he can share the recovery.

348 N.C. at 162, 500 S.E.2d at 73 (quoting *Boeing Co. v. Van Gemert*, 444 U.S. at 480-81, 62 L. Ed. 2d at 683 (footnote omitted)).

"The controlling standard for determining attorneys' fees is one of reasonableness under the circumstances of the particular case in light of the results or success obtained." A. Conte, 1 ATTORNEY FEE AWARDS 44 (1993) (citing *Hensley v. Eckerhart*, 461 U.S. 424, 103 S.Ct. 1933, 76 L.Ed.2d 40 (1983), and *Boeing Co. v. Van Gemert*, 444 U.S. 472, 100 S. Ct. 745, 62 L.Ed.2d 676 (1980)). *See O'Brien v. Plumides*, 79 N.C. App. 159, 339 S.E.2d 54 (1986), *cert. dismissed*, 318 N.C. 409, 348 S.E.2d 805 (1986) (totality of circumstances applies to determining proper fees of attorney discharged by client).

The United States Supreme Court has invariably computed common fund attorneys' fee awards as a reasonable percentage of the fund. *See, e.g., Boeing Co. v. Van Gemert*, 444 U.S. 472, 100 S. Ct. 745, 62 L.Ed.2d 676 (1980); *Central Railroad & Banking Co. v. Pettus*, 113 U.S. 116, 5 S. Ct. 387, 28 L.Ed. 915 (1885). *See also Blum v. Stenson*, 465 U.S. 886, 900 n.16, 104 S. Ct. 1541, 1550 n.16, 79 L.Ed.2d 891 (1984) ("Unlike the calculation of attorney's fees under the 'common fund doctrine,' where a reasonable fee is based on a percentage of the fund bestowed on the class . . . .").

An alternative to the percentage-of-the-fund approach is the lodestar approach in which attorney time is multiplied by an hourly rate and further enlarged by a "multiplier." Some courts apply the percentage-of-the-fund approach but use the lodestar approach as a cross-check.

As noted in *In re NASDAQ Market-Makers Antitrust Litigation*, 187 F.R.D. 465 (S.D.N.Y. 1998), the percentage-of-the-fund approach "allowed for the cost of litigation to be spread proportionately among each of the beneficiaries, prevented unjust enrichment by class counsel at the

expense of the class, and yet provided an incentive to the bar to pursue cases where the prospect of compensation is uncertain and remote in time. . . . Others have favored the percentage method because it more closely aligns the interests of the class and its counsel." 187 F.R.D. at 483 & 484 ("It now appears that the trend among courts is to apply the percentage approach.") (citing cases). *See Camden I Condominium Ass'n, Inc. v. Dunkle*, 946 F.2d 768, 774 (11th Cir. 1991) (percentage-of-the-fund approach permits the court to focus on "a showing that the fund conferring a benefit on the class resulted from [the attorneys'] efforts.").

It appears to the Court that the percentage-of-the-fund approach is the prevailing method in common fund cases in this State, in Federal Courts and in other states.

Based on a thorough review of the documents and statements made to the Court and the Court's familiarity with this litigation, the Court makes the following Findings of Fact:

FINDINGS OF FACT

1. This Class Action is everything a class action should be. From the point of view of Class Members, this litigation meant:

- Receiving payments in cash of more than 85% of a recovery exceeding $800 million (an average refund exceeding $3000 for each qualified Class Member after attorneys' fees) and a 100% tax exemption from State income taxes on their government retirement benefits for the rest of their lives, an additional benefit to the Class as a whole estimated at $9.4 billion. As of the date of this Order, Class Members are well into the twenty-seventh month of tax-free government retirement benefit payments due to the efforts of Class Counsel.

- The vindication of important constitutional and contractual rights.

- Litigation conducted on their behalf in which Class Counsel assumed the risk of loss. Had Class Counsel not prevailed, Class Members would have been no worse off than before and would not have had to pay a penny for the dedicated efforts of dozens of attorneys over a period exceeding ten years.

- Litigation resulting in a real, not a phantom, recovery. Unlike some class actions, Class Members here will not receive discount coupons or a few pennies on the dollar but rather a substantial return of the taxes they paid over a nine-year period (for which they will pay less than 15 cents for every dollar recovered) as well as a 100% lifetime State tax exemption of their government retirement benefits (for which they pay nothing). By any measure, Class Members received a bargain.

2. From the point of view of Class Counsel, this litigation meant:

- The dedication of approximately 50,000 hours of attorney and paralegal time and the commitment of financial resources for over a decade to a cause vigorously and capably opposed by the Attorney General of North Carolina and for which Class Counsel would not have received one penny had they not prevailed. Class Counsel bore great risk.

- The dedication of major portions of legal careers to this litigation in a cause that was not popular among certain segments of the public and for which the prospect of an easy settlement was, as confirmed by the history of this litigation, virtually nil.

- The undertaking of difficult litigation involving numerous complex factual and constitutional issues, almost all of which had to be won for any recovery to result and for which there was little or no precedent in this State; indeed, at times during the course of this litigation what precedent existed was not favorable to certain positions urged by Class Counsel.

3. From the point of view of the Court, this litigation meant:

- Presiding over a class action in which, unlike class actions that piggy-back onto an investigation or verdict obtained by the government, Class Counsel took on the government and had to forge all parts of the case, including the factual record as well as legal theories.

- Presiding over a class action in which Class Counsel and counsel from the Attorney General's Office zealously put forward the positions of their respective clients in a manner which assisted the Court in considering the complex issues in this litigation.

- Presiding over a class action in which Class Counsel encouraged the active participation of Class representatives and Class Members.

- Presiding over a class action in which Class Counsel never gave up. Class Counsel could have ethically "cut their losses" at several stages in this litigation and Class Members would have received nothing. Class Counsel, however, did not give up and Class Members attained significant benefits as a result.

- Presiding over a class action in which Class Counsel accomplished a unique method of settlement with respect to both negotiations with the leadership of the General Assembly and the process of administering the Settlement Fund to the benefit of Class Members.

I. HISTORY OF THE LITIGATION

4. Class Counsel brought actions on behalf of North Carolina State and local governmental retirees to regain for them an exemption from State income taxation taken away by an August 12, 1989, Act of the North Carolina General Assembly and on behalf of Federal government retirees to obtain for them the same tax exemption which had been enjoyed by the State and local governmental retirees. Both efforts were vigorously opposed by the State. This litigation led to several appeals as well as a two-week trial in *Bailey v. State of North Carolina*, 92-CVS-10221, including the testimony of twenty-four witnesses and 1,689 pages of transcript. Opinions of the North Carolina Supreme Court as well as this Court have commented upon the nature, duration and complexity of this litigation. *See, e.g., Bailey v. State of North Carolina*, 348 N.C. 130, 500 S.E.2d 54 (1998) (reciting history of this litigation); this Court's *Order Approving Class Action Settlement* (October 7, 1998).

5. On May 8, 1998, the North Carolina Supreme Court upheld this Court's ruling that the August 12, 1989, legislation violated the constitutional and contractual rights of State and local governmental retiree Class Members and further concluded that the claims of taxpayers who failed to protest the tax under the terms of N.C. Gen. Stat. § 105-267 were not barred *See Bailey v. State of North Carolina*, 348 N.C. 130, 500 S.E.2d 54 (1998) ("*Bailey II*").

6. Following the North Carolina Supreme Court's remand of *Bailey v. State of North Carolina*, 92-CVS-10221, plaintiffs recognized that payment pursuant to the opinion of the Supreme

Court likely required an appropriation of the North Carolina General Assembly and that the General Assembly might try to provide for "refunds" through tax credits. Plaintiffs recognized that tax credits would be of little value to Class Members because, following *Bailey II*, many of those Class Members would have little or no taxable income from which to deduct tax credits and that tax credits might be made available to other Class Members only over the course of many years.

7. At the same time, the remand following *Bailey II* provided the parties an opportunity to resolve issues related to State and local governmental retiree claims subsequent to the tax years covered by *Bailey II* and to resolve the lawsuit brought on behalf of Federal government retirees, *Patton v. State of North Carolina*, which turned in part on success in *Bailey II*. Thereafter, Class Counsel and leaders in the North Carolina General Assembly entered into direct settlement negotiations. Those negotiations resulted in an extraordinary settlement which provided for a common fund settlement of $799 million paid by the State of North Carolina into a Settlement Fund in two installments, plus an additional $3.2 billion in the present value of future tax exemptions. The tentative settlement was memorialized in a June 10, 1998, *Consent Order* entered in this Court. The Consent Order provided, in relevant part, that "Attorneys fees, costs and the expenses of administration shall be determined by the Court and shall be paid from the Settlement Fund." *Consent Order* ¶ 7.

8. Under the Court's direction, Class Counsel provided extensive notice of the proposed settlement and of their fee request to potential Class Members. Class Members were informed of a set aside of fifteen percent (15%) of the Settlement Fund contemplated in the proposed settlement which would be used to pay attorneys' fees and litigation costs and the expenses of administering the proposed settlement (the "Reserve Fund"). Class Members were also informed of their right to

object to the proposed settlement and to attorneys' fees as well as their right to be heard at a July 22, 1998, Fairness Hearing. The notice efforts, including direct mailing to more than a hundred and fifty thousand readily identifiable potential Class Member, extensive publication and media publicity efforts, and a toll-free telephone number and Internet site for Class Members, fully satisfied the due process requirements related to Class Counsel's fee request.

9. Although less than a dozen individuals in the Class estimated to include at least 200,000 Class Members (less than one-one hundredth of one percent) made any statement (written or oral) formally objecting to the Fee Petition or to the fifteen percent (15%) Reserve Fund, the Attorney General vigorously opposed the attorneys' fee request in a July 21, 1998 Response to the Fee Petition, in an August 14, 1999 Supplemental Response, and in open court.

10. The Court also received affidavits from Class Members, including several retired distinguished members of the judiciary, as well as resolutions of retiree organizations such as The North Carolina State and Local Employees Tax Rights Committee and The Federal Retiree Tax Equity Task Force, supporting attorneys' fees and costs of up to fifteen percent (15%) of the common fund.

11. On July 22, 1998, the Court conducted the noticed Fairness Hearing and took evidence with respect to approval of the proposed Settlement and with respect to the Fee Petition. The Court heard from all persons who wished to be heard and appeared at the hearing. The July 22, 1998, hearing has been continued from time to time pending resolution of the award of attorneys' fees.

12. On October 7, 1998, following the notice to Class Members of the proposed settlement and the Fairness Hearing in the consolidated cases, this Court approved the Settlement,

effective July 1, 1998. In the *Order Approving Class Action Settlement*, the Court set aside fifteen percent (15%) of the Settlement Fund as the "Reserve Fund" for payment of attorneys' fees and litigation costs, and the expenses of administering the settlement. *Order Approving Class Action Settlement* ¶ 3, at 8 (October 7, 1998).

13. The first refund round to Class Members, which refunds a portion of taxes paid on government retirement benefits above the $4,000 annual deduction, is well underway. Following processing of the remaining Claim Forms and a determination of funds remaining for distribution to the Class, this Court will direct a second round of refunds, which refunds will be appreciably larger than the first round of refunds.

II. APPLICATION OF THE COMMON FUND DOCTRINE TO THIS LITIGATION

14. As a preliminary matter, the Court must determine the composition of the common fund from which attorneys' fees will be paid and litigation expenses reimbursed. The quantifiable whole of the benefit to Class Members constitutes the common fund. *See Bailey v. State of North Carolina*, 348 N.C. 130, 160, 500 S.E.2d 54, 71 (1998) ("The United States Supreme Court noted . . . [that] 'a reasonable attorney's fee [is awarded from] the fund as a whole'."). The common fund recovery in these consolidated cases, for the purposes of this Order, is the $799 million paid by Defendants under the Settlement, a unique recovery in the history of this State by any measure even without consideration of the estimated $3.2 billion present value of future tax exemptions. The recovery follows years of work by Class Counsel who risked not being paid if they did not prevail. Under the Settlement, qualified Class Members are receiving substantial tax refunds and since tax year 1998 have received a 100% tax exemption of their government retirement benefits from North Carolina state income tax. This recovery of a determinant fund for the benefit of qualified Class

Members satisfies the factors used by the North Carolina Supreme Court in *Bailey II* to determine the existence of a common fund.

15. Under the facts and circumstances of these consolidated cases, the percentage-of-the-fund approach is the proper method of determining reasonable attorneys' fees. The Court will consider the time and effort of Class Counsel, however, as part of a review of factors relevant to determining reasonable attorneys' fees.

A. **Evaluation of Factors in this Litigation**

16. Although the result of the litigation is the paramount consideration in awarding attorneys' fees, the Court has considered all relevant factors. The Fifth Circuit Court of Appeals listed twelve factors relevant to the inquiry in *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714 (5th Cir. 1974). The *Johnson* factors are mirrored in Rule 1.5 of the North Carolina Revised Rules of Professional Conduct which sets out a nonexclusive list of factors relevant to consideration of whether a fee is "clearly excessive." Each factor supports the finding that the attorneys' fees awarded in this Order are reasonable.

17. In determining a reasonable attorneys' fee, the Court finds certain factors to be particularly relevant: (a) benefit to the Class (the results obtained); (b) customary fees in like cases; (c) novelty and difficulty of the questions involved and the corresponding risk involved; (d) skill needed by Class Counsel; (e) time and labor involved; and (f) other relevant factors set out in the North Carolina Revised Rules of Professional Conduct.

18. **Benefit to the Class (Amount of Money Involved and the Results Obtained).** Any assessment of the relevant factors begins with an analysis of the benefit created for the Class by the efforts of Class Counsel. The recovery, the fund itself in these consolidated cases, is the best

measure of success and logically serves as "the benchmark from which a reasonable fee will be awarded." *See* H.B. Newberg & A. Conte, 3 NEWBERG ON CLASS ACTIONS § 14.03 (3d ed. 1992). The result in these consolidated cases has been singular in the history of class actions in North Carolina and has few rivals outside the State.

19. The Court has struggled to put the size of this common fund recovery in context. The $799 million recovery (now well over $840 million with accruals) is larger than the gross domestic product (the annual value of finished goods and services produced within a nation) of many countries. *See* Central Intelligence Agency, *The World Factbook 1999* (prepared for use by U.S. government officials). If the recovery in this litigation was converted into one-dollar bills which were then laid end-to-end, the recovery would circle the Earth *three times* with several thousand miles left over. This is an astounding recovery.

20. The Court also takes note of the Court-appointed Referee's observation in his April 29, 1999, *Report of Referee* that the future benefit of this litigation, "[a]ccording to the undisputed Affidavit of Charles R. Dilts, class counsel's expert, . . . as a result of the settlement of these cases, is the gross amount of $9.4 billion, which has a present value of approximately $3.2 billion. These amounts are relevant for consideration of Factor (4) above," i.e., the amount involved and the results obtained. *Report of Referee*, at 19. When the $4 billion present value of this litigation is considered ($799 million recovery plus the $3.2 billion present value of future benefit), the attorneys' fees awarded are less than two percent (2%) of the benefit to the Class. In computing the fee to be paid, however, the Court considers only the present cash common fund recovery itself.

21. In addition to the size of the common fund, it is appropriate to consider the average recovery by Class Members. The approximately 200,000 qualified Class Members will on average

receive more than $3000 each from the common fund even after payment of attorneys' fees and expenses and the costs of administration. Some Class Members will receive little while others will receive refunds well in excess of average. In each case, of course, the amount of the refund turns on the amount of taxes paid on government retirement benefits. Class Members are receiving refunds of a substantial portion of the taxes they paid and the total refund to the Class may reach the total taxes paid. Although approximately 25,000 of the more than 210,000 Claim Forms submitted await processing, the current estimate is that the Settlement Fund, excluding the fifteen percent (15%) Reserve, will nearly equal, and possibly exceed, the total taxes paid by qualified Class Members.

22. **The Risk Involved: Novelty and Difficulty of the Questions Involved.** This Class Action involved both novel and difficult issues. Singly but especially when combined with the able defense provided by the Attorney General, these novel and difficult issues meant that Class Counsel faced great risk that they would not be paid even after years of litigation. There was scant legal precedent in support of the issues of law faced by Class Counsel. No previous bench or jury trial similar to these consolidated cases had been reported to provide Class Counsel with a guide. These were truly cases of first impression in this State with little authority from other jurisdictions to provide assistance. Indeed, the history of this litigation demonstrates that these consolidated cases involved extremely difficult issues which Class Counsel continued to fight even after more than one rebuff by the courts. These consolidated cases made and changed North Carolina law as evidenced, for example, by the North Carolina Supreme Court's opinion in *Bailey v. State of North Carolina*, 348 N.C. 130, 500 S.E.2d 54 (1998), with respect to application of the notice requirements in N.C.

Gen. Stat. § 105-267 to those who did not protest payment of the tax on government retirement benefits.

23. Class Counsel faced and overcame substantial obstacles during the course of this litigation. Success by the Defendants on any one of their numerous defenses would have entirely eliminated or, in some cases, vastly reduced the recovery and future benefit for Class Members and, thereby, eliminated or minimized attorneys' fees for Class Counsel. The defenses and obstacles faced and overcome by Class Counsel include the bar of sovereign immunity, proving the existence of a vested contractual obligation of the State and impairment of that obligation, countering the defenses to an unconstitutional impairment of contracts, overcoming the bar of recovery for taxpayers who failed to protest the tax within the statutory period, avoiding the possibility that refunds would be made over a number of years and in the form of tax credits, and timely resolving issues related to numerous defenses of the State against the claims of Federal government retirees. Class Counsel had to overcome each of these legal defenses and factual obstacles to prevail on behalf of Class Members. Each defense and obstacle presented a considerable risk of defeat.

24. **Skill needed by Class Counsel.** These consolidated cases required extraordinary efforts on the part of Class Counsel in planning, litigation strategy, legislative strategy due to the fact that payment in these cases turned ultimately on a legislative appropriation, complex constitutional issues of first impression, unique trial and evidentiary obstacles, appellate skills, and, not an insignificant factor in this massive Class Action, keeping the tens of thousands of Class Members informed of the progress of the litigation. Class Counsel started from "ground zero" in developing case authority and facts, and legal arguments, to support Plaintiffs' position on the issues.

25. The Attorney General's Office has, from the very beginning of this litigation, provided an able and tenacious defense to all of the relevant cases, which defense resulted in numerous appeals to the North Carolina Supreme Court. Extraordinary lawyering skills on the part of Class Counsel were required to obtain the result they did in the Supreme Court and in negotiating the eventual settlement herein.

26. **Time and Labor Required and Time Limitations Imposed.** Class Counsel and their co-counsel have invested significant time in this litigation. When preparing for and undertaking trial and in responding to various motions and in prosecuting appeals, Class Counsel often had to devote considerable resources due to the time limitations imposed by the circumstances.

27. In order to assist the Court in setting a reasonable attorneys' fee under the circumstances of this litigation, the Court determined that it might be beneficial to examine the hours incurred by Class Counsel in the various related cases.

28. At the suggestion of the Attorney General and Class Counsel, a Wake County attorney was selected and agreed upon by the Attorney General and Class Counsel to review the time records of Class Counsel. On October 7, 1998, the Court appointed Charles F. Blanchard, Esq., as Referee to review the time records of Class Counsel and co-counsel and to report on "the time and value of time expended by counsel" and to review and summarize confidential attorney/client records. Mr. Blanchard, with the assistance of Emily Copeland Cato, Esq., undertook an exhaustive review of the time records and reported their findings to the Court on April 29, 1999. The Attorney General and Class Counsel received copies of the April 29, 1999, *Report of Referee*.

29. The Court has reviewed the April 29, 1999, *Report of Referee* and is impressed by the thoroughness of the Referee's effort and the clarity of the information summarized and the

analysis presented. For the purposes of this Order, the Court will highlight several of the statements and findings of the Referee which the Court accepts and adopts except as otherwise stated.

30. The Referee found, and the Court accepts, that Class Counsel expended, through the closing date of the time records reviewed by the Referee, 44,745 hours in this litigation, which has been updated since the time records considered by the Referee by an additional 3,126 hours through the end of December 1999, for a total of 47,871 hours. Class Counsel's efforts continue and it appears to the Court that by the time all appeals are resolved and the administration of the Settlement is completed, the total time in this litigation (excluding nonattorney time devoted to administration of the Settlement) will exceed 50,000 hours. This total includes all the litigation, including two prior cases on behalf of Federal government retirees and State and local governmental retirees, respectively. None of the types of activities undertaken (litigation, public and class relations, following taxpayer litigation in other states, settlement/legislative activities) are outside the scope of Class Counsel's duties to Class Members. *Report of Referee*, at 10-15 (April 29, 1999).

31. The pre-judgment and post-judgment time expended in this litigation has been significant and Class Counsel have expended and will continue to expend substantial time in the administration of the Settlement.

32. A question has arisen as to whether the time involved in the predecessor cases to this Settlement (*Swanson v. State of North Carolina* and the first *Bailey v. State of North Carolina* (*Bailey I*)) should be included in the Court's consideration. The Court finds that it should. *Swanson* and *Bailey I* as well as these consolidated cases are all part and parcel of the same dispute. *Swanson* was not "lost" at all on the overriding question of whether the taxation was proper but ran afoul of the protest requirement in N.C. Gen. Stat. § 105-267. In this respect, *Swanson* (and *Bailey I*) were

necessary to flush out the law. The understanding developed in working with Federal government retirees in *Swanson* and State and local governmental retirees in *Bailey I* proved useful in reaching the Settlement. Further, discovery and research in *Swanson* proved useful in the *Bailey* cases.

33. The Court is well-aware of the differences and similarities of the consolidated cases and the prior cases brought by Class Counsel on behalf of governmental retirees. These differences and similarities were summarized by the Referee:

> The Referee understands that the time spent by counsel and the expenses incurred in the Swanson cases are subject to debate by both sides as to their relevance to an attorney fee award in Bailey II/Emory/Patton. On one hand we understand that the legal issues were different. (The Swanson cases were trying to apply Davis v. Michigan for federal retirees who had paid North Carolina taxes on their retirement, before the legislature changed the law and gave both federal and state retirees a $4,000 exemption. The Patton case was seeking relief for federal retirees based on the Bailey II decision; i.e., that their federal retirement should be totally tax-exempt just like state retirement.) Many of the remedies which were being sought in Swanson, such as a refund of taxes paid for tax years 1988 and before, were different; and those cases were "lost" on appeal. We also understand the global argument of class counsel that the Swanson and Bailey cases are all tied together; that the goal of the Swanson cases were to stop the unconstitutional taxation of federal retirement benefits and to recover what had been illegally collected; and that this goal (and more) was reached by the settlement in Bailey II/Emory/Patton. In addition, class counsel was developing a relationship with the same federal retirees as in Patton and learning about their different retirement groups. Discovery and research in Swanson was also useful to the Bailey cases . . . .

Report of Referee, at 16-17 (April 29, 1999).

34. Few if any attorneys will be willing to undertake class action lawsuits on a contingency basis if they know that their fee will be reduced if every procedural point is not won the first time encountered--even if they are successful in the end and their clients receive 85% or more

of the recovery and complete relief for the future. There will be little incentive to persevere in many cases given this heightened risk. There will be little incentive to take the heightened risk in the first place.

35. Class Counsel could have incurred many more hours had they continued litigating the Federal government retiree claims rather than settling. The fact that Class Counsel exercised their legal judgment and followed the considered opinion of a very active group of Class representatives in settling the claims of Federal government retirees rather than engaging in prolonged and uncertain litigation should not be used to punish Class Counsel through a decreased fee award. At the July 22, 1998, Fairness Hearing the Attorney General's representative eloquently and forcefully detailed the extensive and serious defenses the State intended to raise in *Patton* had those claims not been settled. This Court is well aware of the skill and competitive spirit of the defense here. Rather than risk no recovery in *Patton*, a settlement was reached which not only provided a substantial refund of taxes paid but also provided complete relief for tax year 1998 forward.

36. It appears to the Court that all of the original cases handled by Class Counsel benefitted directly, indirectly and in various ways all Class Members and should at least be considered by the Court in determining reasonable attorneys' fees.

37. Even without the *Swanson* and *Bailey I* time, however, Class Counsel will have spent more than 20,000 hours in these consolidated cases before the litigation is finished. Should the Court use lodestar as a cross-check, this time warrants the fees requested by Class Counsel.

38. The Court concludes that the time and labor involved in the consolidated cases presently before the Court (excluding time in prior cases and excluding time related to administration

of the Settlement) fully justify the attorneys' fees awarded in light of the Court's conclusions as to other relevant factors.

39. **Customary Fees in Like Cases.** As a preliminary matter, the Court observes that there have been few, if any, "like cases" in the history of North Carolina. The Court, however, is guided by common fund fee orders in other North Carolina cases and by the goal of awarding fees from common funds. "The object in awarding a reasonable attorney's fee . . . is to simulate the market . . . The class counsel are entitled to the fee they would have received had they handled a similar suit on a contingent fee basis, with a similar outcome, for a paying client." *In re Continental Illinois Securities Litigation,* 962 F.2d 566, 572 (7th Cir. 1992).

40. "The majority of common fund fee awards fall between 20% to 30% of the fund." *Camden I Condominium Ass'n, Inc. v. Dunkle*, 946 F.2d 768, 774-75 (11th Cir. 1991). The Court notes that many courts employing the percentage-of-the-fund approach use, as a "benchmark" fee, 25% of the common fund recovery. *See, e.g., Six (6) Mexican Workers v. Arizona Citrus Growers*, 904 F.2d 1301, 107 A.L.R. Fed 779 (9th Cir. 1990) (25% of total damages recovered in class action a "benchmark" award). The "benchmark" is only the starting point of the analysis. The determination of reasonable fees by the Court depends on the circumstances of the case.

41. The fee agreements with named Plaintiffs and others in this litigation provided for a minimum fee of twenty-five percent (25%) of any recovery of taxes for services rendered through trial or thirty-three and a third percent (33-1/3%) of any recovery of taxes for services rendered through appeal.

42. The Court has reviewed common fund fee awards by other North Carolina courts. The courts in *Faulkenbury v. State of North Carolina*, 90 CVS 12090, 91 CVS 00368, 92 CVS

11978, 96 CVS 12524, Wake Co. Sup. Ct. (May 11, 1998), and *Long v. Abbott Laboratories*, 97 CVS 8289, Mecklenburg Co. Sup. Ct. (July 30, 1999), awarded attorneys' fees of ten percent (10%) of the common fund.

43. A review of the fee order in *Long* demonstrates why Class Counsel's requested fee award in these consolidated cases is reasonable. The court in *Long* concluded that the settlement was a cost of litigation settlement in which class members received little benefit and that class counsel in that case should not be rewarded on the same basis as if they had taken the risks associated with certification and trial of the merits and prevailed, or at least obtained a significant settlement. The award of ten percent (10%) of the recovery was made in *Long* even though:

> Class Counsel did not accomplish anything of significance for the class in this litigation. In other cases, this court has recognized the efforts of class counsel when they have overcome difficult odds to achieve an unexpected result for class members. *See* this Court's fee award in *Byers v. Carpenter*, No.94 CVS 04489 (Wake Co. Sup. Ct. (1998)) (Tennille, J.) (*where class counsel turned the proverbial sow's ear into a silk purse*). *In this case, what was a sow's ear at the outset remained mammalian in composition through settlement.*

Long Order, at 13 (emphasis added).

44. The Court contrasts the findings in *Long* with the effective prosecution by Class Counsel of these consolidated cases. Every factor which the court in *Long* used to "limit" the fee award to 10% of the recovery favor an increased award in *Bailey/Emory/Patton*. The risk here was real and substantial. The benefit here is and will be substantial and direct to each Class Member. The sow's ear was indeed changed into a silk purse.

45. This was a contingency fee case. In North Carolina, contingency fees typically range from 25% to 33-1/3% of the recovery. Although consideration of other North Carolina cases

suggests an award well in excess of ten percent (10%) of the common fund under the circumstances of this litigation, this Court must also take into account the fact that the recovery in this case greatly exceeded that in *Faulkenbury* and *Long*. "[P]ercentage awards in *megafund* cases range from 4.1 percent to 17.92 percent of the fund." *In re NASDAQ Market-Makers Antitrust Litigation*, 187 F.R.D. 465, 486 (S.D.N.Y. 1998) (emphasis added) (citing *In re Prudential Ins. Co. of America Sales Practices Litigation*, 962 F. Supp. 572, 585 (D.N.J. 1997), *rev'd and remanded*, 148 F.3d 283 (3d Cir. 1998)). Different courts take different approaches when considering attorneys' fees in very large common fund cases. Some courts view a large recovery as more difficult to obtain and of greater benefit to the Class and, as a consequence, increase the percentage awarded as the fund increases. Other courts take the opposite approach and decrease the percentage awarded as the fund increases. For example, the Federal District Court for the Northern District of Illinois recently reduced attorneys' fees on a $700 million recovery from the requested 30% of the recovery to 25% in light of the large recovery in that case. *In re Brand Name Prescription Drugs Antitrust Litigation*, 94 C 897, MDL 997, 2000 WL 204112 (N.D. Ill. Feb. 10, 2000). In these consolidated cases, the Court has effectively made that reduction by placing a 15% cap on attorneys' fees, litigation expenses, and the costs of administering the Settlement.

46. The Court also reviewed common fund fee awards in similar-sized class actions outside the State (an inquiry necessitated because of the unprecedented recovery in these consolidated cases). For example, in *In re Brand Name Prescription Drugs Antitrust Litigation*, 94 C 897, MDL 997, 2000 WL 204112 (N.D. Ill. Feb. 10, 2000), the Court awarded $175 million of a $700 million recovery (25%) to class counsel. In *In re NASDAQ Market-Makers Antitrust Litigation*, 187 F.R.D. 465 (S.D.N.Y. 1998), the court approved a $1.027 billion settlement of a class

antitrust action. The court concluded that the percentage method, rather than the lodestar method, was appropriate for fixing counsel's fees in megafund common fund cases because it aligned the interests of the attorneys and the parties. After observing that fees in the range of 6-10% are common in megafund cases reflecting economies of scale, and after concluding that an upward adjustment from the benchmark in such cases was warranted, the court approved a 14% fee. 187 F.R.D. at 482-88.

47. **Whether the Fee is Fixed or Contingent.** Class Counsel took these consolidated cases on a contingency fee. Recovery of any attorneys' fees, therefore, was contingent on the degree of success of Class Counsel. All risks of loss were borne by Class Counsel.

48. **Preclusion of Other Employment.** Class Counsel and co-counsel have been precluded from undertaking other employment due to the demands of this litigation. Class representatives, many of whom are experienced judges and high ranking military and executive retirees, knew from the beginning that Class Counsel would have to devote considerable resources to the litigation. The Court acknowledges Class Counsel's statement that the enormous amount of time dedicated to these consolidated cases resulted in significant opportunity costs to Class Counsel and co-counsel for work that could have been undertaken for clients who would have paid counsel on a monthly basis. Indeed, legal work for many of the regular clients developed and maintained by Mr. Boyce over his decades of practice had to be declined or referred to other attorneys due to the increasing demands of this litigation. Womble Carlyle Sandridge & Rice, PLLC ("Womble Carlyle"), from the beginning, unconditionally committed attorneys and staff to the litigation and provided necessary financial support. That commitment continued throughout the decade of litigation which followed.

49. **Experience, Reputation and Ability of Class Counsel.** Class Counsel are known to the Court professionally through reputation and through numerous court appearances and professional activities. Class Counsel are experienced in matters of trial and appellate practice and were ably assisted by co-counsel throughout this litigation. Class Counsel's ability speaks for itself through the ultimate success obtained in this litigation.

50. **Nature and Length of Professional Relationship with the Client.** The professional relationship which developed between Class Counsel on the one hand and Class representatives and Class Members on the other hand (including leaders of various retiree organizations) played an important role in reaching the Settlement.

B. **Summary of Findings of Fact Regarding Fee Request**

51. After due consideration, the Court finds that under the circumstances of these consolidated cases an attorneys' fee of eight percent (8%) of the common fund of $799 million, resulting in attorneys' fees of $63,920,000.00, is fair and reasonable.

52. As a cross-check of the percentage selected, the approximately 50,000 hours invested in this litigation times an average rate of $250 per hour and times a multiplier of five results in a fee award of $62,500,000.00.

53. The Referee noted that "[i]n some common fund cases, the Referee has read decisions where the judge had to decide how to apportion the attorney fee award among several different class counsel from different law firms who had started out representing different plaintiffs. In this case the Referee is advised that all the named plaintiffs have contracts with Womble Carlyle. In addition, the Referee is advised that [Charles] Taylor and [Class Counsel] Boyce have private contracts with Womble Carlyle regarding apportionment of any attorney fee award. The other Class Counsel, Mr.

Vaughan, is a partner at Womble Carlyle. Mr. Taylor and Womble Carlyle have incurred separate expenses. Therefore the Referee recommends that the Court make its award as one attorney fee award to Womble Carlyle and two separate expense awards to Taylor and Womble Carlyle." *Report of Referee*, at 19-20.

54. The Court has determined that it is appropriate to direct the payment of the attorneys' fees awarded by this Order in two installments similar to the two refund rounds to Class Members.

C. **Consideration of Application for Supplemental Attorneys' Fees**

55. Many activities relating to the administration of the Settlement are currently pending which may have an impact on the ultimate recovery by Class Members individually and collectively. The Court cannot at this time determine the full value of those activities to the Class and determine what amount of additional attorneys' fees, if any, might reasonably be due Class Counsel for their efforts. On the other hand, it would be unfair to Class Counsel, who have patiently waited more than eighteen months from the entry of the *Consent Order* tentatively approving the Settlement, to wait even longer before receiving an award of attorneys' fees. Any additional award of attorneys' fees should occur only if both the total amount refunded to Class Members as a whole substantially repays the equivalent of all of the taxes paid by Class Members as a whole and such an award could be justified.

III. REIMBURSEMENT OF COSTS AND EXPENSES

56. The reimbursement of litigation costs and expenses is appropriate in common fund recoveries. The April 29, 1999, *Report of Referee* presented the results of the Referee's examination of the detailed expense records of Mr. Taylor and Womble Carlyle. Mr. Taylor's records show $9,444.00 in travel costs relating to the litigation, including the prior cases. Womble Carlyle's

records included expenses for copies and printing, reporting service fees, computer research, and travel and other expenses in the unreimbursed amount of $152,826.94. Mr. Boyce made no independent request for reimbursement of expenses.

57. The Referee, after reviewing the details comprising the summary of expenses provided in the *Report of Referee*, concluded that "the unpaid items [of Womble Carlyle], plus Mr. Taylor's travel expenses are appropriate expenses for reimbursement." *Report of Referee*, at 10. This Court agrees.

IV. ATTORNEYS' FEES IN PERSPECTIVE

58. This Class Action is everything a class action should be. Never has so much been done for so many as a result of a lawsuit brought on behalf of North Carolina taxpayers.

59. The attorneys' fees awarded and expenses reimbursed, together with all the costs of administering the Settlement, result in Class Members paying, in effect, less than fifteen cents on each dollar recovered on their behalf and nothing for their future tax exemption.

60. In addition to considering the success of Class Counsel from a jurisprudential point of view, the Court has considered ways in which the success of Class Counsel may be translated to fields of endeavor more familiar to Class Members. Examples of putting a dollar value on personal service and performance based on the market are plentiful in today's entertainment and sports worlds. Recently, in professional football the Denver Broncos concluded that Terrell Davis was worth $54 million for playing sixteen games a year for nine years ($375,000 for each one-hour game). Jamal Anderson, an Atlanta Falcon, held out for a five year, $32 million deal (some $400,000 per game). For *the year* in which this litigation settled, Michael Jordan earned $69 million ($29 million in salary and $40 million in endorsements and other income), James Cameron, director

of *Titanic*, made $115 million, actor Harrison Ford made $58 million, singer Celine Dion $56 million, Oprah Winfrey $125 million, Jerry Seinfeld $267 million, and the Spice Girls $49 million according to *Forbes* magazine (*Forbes*, March 22, 1999). Tiger Woods earned over two million dollars golfing in the first two months of 2000 (and several millions more from endorsements). This litigation *lasted over a decade* and success was due not only to the extraordinary efforts and tenacity of Class Counsel but also that of dozens of attorneys working with them.

61. The Court suspects that Class Counsel could not survive for more than a few seconds in an NFL game, could not swing a driver like Tiger Woods, could not direct a blockbuster movie nor, in all likelihood, carry much of a tune. On the other hand, the Court cannot imagine the greatest sports or entertainment superstar being responsible for protecting the constitutional rights of more than 200,000 citizens of this State.

62. By stating this analogy, the Court does not intend to compare the work of lawyers to that of sports and entertainment stars. On the other hand, the Court is not aware of any person or private entity who has brought as significant and tangible a benefit to so many government retiree taxpayers in North Carolina as have Class Counsel.

63. Class Counsel have achieved an unprecedented refund for North Carolina taxpayers, both in terms of the total refund and in terms of the vindication of the rights of taxpayers to challenge the unconstitutional imposition of taxes. Class Counsel, through their efforts, benefitted hundreds of thousands of retirees and taxpayers who would otherwise have recovered nothing and indeed would still be paying taxes on their government retirement benefits.

Based on the foregoing Findings of Fact, the Court makes the following:

CONCLUSIONS OF LAW

1. Class Counsel and their co-counsel are entitled to reasonable attorneys' fees of eight percent (8%) of the common fund of $799 million.

2. Womble Carlyle Sandridge & Rice, PLLC, is entitled to unreimbursed litigation expenses in the amount of $152,826.94 and Charles Taylor is entitled to unreimbursed litigation expenses in the amount of $9,444.00.

FOR GOOD CAUSE SHOWN, IT IS, THEREFORE, ORDERED, ADJUDGED AND DECREED THAT:

1. Class Counsel and their co-counsel are awarded attorneys' fees of eight percent (8%) of the common fund of $799 million, which award is effective immediately subject only to the timing of payment. The first installment of four percent (4%) of the common fund of $799 million shall be paid within twenty (20) days of the date of this Order. The second installment of four percent (4%) of the common fund of $799 million shall be paid upon substantial completion of the administration of the Settlement Fund, which event shall occur upon the bulk mailing of the second refund checks to Class Members.

2. Womble Carlyle Sandridge & Rice, PLLC, is awarded $152,826.94 in unreimbursed expenses and Charles Taylor is awarded $9,444.00 in unreimbursed expenses. These expenses shall be paid within twenty (20) days of the date of this Order directly to Womble Carlyle Sandridge & Rice, PLLC, and Mr. Taylor, respectively.

3. The attorneys' fees and expenses shall be paid from the fifteen percent (15%) Reserve Fund established by the October 7, 1998, *Order Approving Class Action Settlement*. The attorneys'

fees awarded shall be paid to Class Counsel for further distribution in accordance with agreements between Mr. Boyce, Mr. Taylor and Womble Carlyle Sandridge & Rice, PLLC.

4. In the event that qualified Class Members in the aggregate receive substantially all of a total refund of taxes paid which are subject to refund under the Court-approved Plan of Settlement Administration and other orders of the Court, Class Counsel may apply to the Court for a Supplemental Award of attorneys' fees if such fees can be justified.

5. A copy of this Order shall be served on the attorneys of record in these consolidated cases.

This the 7 day of March, 2000.

JACK A. THOMPSON
SUPERIOR COURT JUDGE

EXHIBIT E

NORTH CAROLINA
WAKE COUNTY

FILED
JAN 22 PM 3:47
WAKE COUNTY, C.S.C.
BY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION

BAILEY, et al., v. STATE OF NORTH CAROLINA, et al.	File Nos. 92 CVS 10221, 94 CVS 6904, 95 CVS 6625, 95 CVS 8230
EMORY, et al., v. STATE OF NORTH CAROLINA, et al.	File No. 98 CVS 0738
PATTON, et al., v. STATE OF NORTH CAROLINA, et al.	File No. 95 CVS 04346

ORDER DIRECTING CALCULATION OF REFUNDS, PAYMENT OF FINAL FEES AND EXPENSES, AND DISTRIBUTION OF FINAL REFUNDS TO CLASS

THIS CAUSE COMING ON TO BE HEARD AND BEING HEARD before the undersigned Judge of Superior Court to whom these consolidated matters were assigned as exceptional cases by Order of the North Carolina Supreme Court, on Plaintiffs' "Motion for Order Necessary for Final Distribution to Class," and the Court having considered the statements of counsel and other evidence presented by interested persons, and the Court having reached the following Findings of Fact:

1. This litigation was brought to recover a full exemption from North Carolina taxation with respect to benefits paid by certain North Carolina State and local government retirement plans and to obtain equal treatment for benefits paid by Federal government retirement plans. The litigation resulted not only in a full tax exemption beginning in tax year 1998, but also in $788 million for direct payments to qualified Class Members, net of the costs of Settlement administration and attorneys' fees.

2. The Parties settled this litigation on 10 June 1998. Class Counsel, under the supervision of the Court, have identified qualified Class Members entitled to participate in the Settlement. On 21 December 2000, the North Carolina Supreme Court resolved the Attorney General's appeal of the 24 March 2000 Memorandum and Order on Application for Assessment of Attorney Fees and Costs ("24 March 2000 Order"), dismissing the appeal. The time has come, therefore, for the Court to enter an order directing final distribution of refunds to qualified Class Members. The estimated date on which distribution of the second round of refunds will begin is 1 March 2001.

HISTORY AND STATUS OF THE SETTLEMENT

3. After remand of the North Carolina Supreme Court's 8 May 1998 decision in Bailey v. State of North Carolina, 348 N.C. 130, 500 S.E.2d 54 (1998), and following extensive negotiations, the Parties entered into a tentative settlement evidenced by the 10 June 1998 Consent Order, with settlement conditioned upon (a) final approval by the Court following notice and a hearing and (b) enactment of a legislative appropriation of the money necessary to make the refunds called for in the Consent Order (collectively, the "Settlement").

4. The Settlement provided for release of taxpayer claims for tax years 1989 through 1997, inclusive, relating to North Carolina income taxes collected on certain government retirement benefits. In exchange for this release, the State of North Carolina agreed to pay the total sum of $799,000,000, payable in two installments.

5. On 30 September 1998, the North Carolina General Assembly enacted legislation, subsequently signed by the Governor into law as Session Laws ch. 1998-164, which approved the Settlement and appropriated the first installment of $400,000,000 called for in the Consent Order.

The Defendants paid the first installment of $400,000,000 effective 1 July 1998 and the second installment of $399,000,000 effective 1 July 1999, which payments, together with accruals less authorized payments, are held by the North Carolina State Treasurer pursuant to the 9 October 1998 Order Approving Office of Treasurer of the State of North Carolina as Holder of the Settlement Fund.

6. After extensive notice of the Settlement to Class Members and a fairness hearing, the Court entered its Order Approving Class Action Settlement giving final approval to the Settlement. The Order directed that eighty-five percent (85%) of the Settlement Fund be set aside and segregated into a "Claims Fund" for the payment of refunds, and that fifteen percent (15%) of the Settlement Fund be set aside and segregated as a "Reserve Fund" for the payment of litigation costs, expenses of administration, and attorneys' fees. Order Approving Class Action Settlement, ¶ 3, at 8 (9 October 1998).

7. The Court next approved a Plan of Settlement Administration. Pursuant to the Plan and orders of the Court, Class Counsel, through the Court-approved Settlement Administration Organization ("SAO") and with the assistance and oversight of the Court-appointed Independent Accountant, have identified and located potential Class Members, obtained information relating to retirement benefits paid to Class Members and relevant tax return information relating to the tax years covered by the Settlement, provided filled-out Claim Forms to potential Class Members when practicable, and processed claims. A claimant whose claim was denied by the Settlement Administration Organization was given a right to appeal to a court-appointed Referee with right of further appeal to this Court.

8. All deadlines for filing a claim have passed. The Settlement Administration Organization received over 220,000 Claim Forms (over two-thirds the total number of potential claims in the SAO database) and has completed processing all claims.

9. The Court-appointed Independent Accountant reported to the Court on 18 August 2000 that the projected average recovery by qualified Class Members who have satisfied all requirements to participate in the Settlement recovery will exceed 110% of the amount of tax paid by the Class.

10. The Independent Accountant and Court-appointed Referee made recommendations of various alternatives regarding the specific calculation of refunds, which the Court has taken under consideration. The Independent Accountant and Referee, among other things, recommended that refunds be made as a percentage of the taxes paid by qualified Class Members together with an interest calculation but that refunds be made as a refund of the principal tax paid until the respective Class Member receives a refund of one hundred percent (100%) of the taxes he or she paid.

FACTORS RELEVANT TO DETERMINATION OF FINAL REFUND TO CLASS

11. It is now time for this Court to determine the amount and method for distribution of available funds to qualified Class Members. The final refund to qualified Class Members depends on four variables: (a) the amount available for distribution to qualified Class Members; (b) the aggregate North Carolina income taxes paid by qualified Class Members on account of government retirement benefits for tax years 1989 through 1997, inclusive; (c) a rate of interest and the interest period; and (d) the allocation of the Settlement Fund as between taxes paid on benefits from North Carolina State and local government retirement plans and on benefits from Federal retirement plans. Once these variables are determined, the taxes and interest to be refunded may be calculated for each

qualified Class Member. The SAO generates Claim Forms according to taxpayer status (i.e., whether the qualified Class Member filed singly or jointly) and it is appropriate, therefore, that the calculations described in this Order be by filing status to the extent practicable.

12. **Funds Available For Distribution To Class.** The first variable which must be quantified is the projected funds available for distribution to qualified Class Members. The Plan of Settlement Administration reported that following payments by the State called for in the Settlement, $679.15 million would be available in the Claims Fund for distribution to qualified Class Members. See Plan of Settlement Administration, at 27-28 ($340 million available after first installment with an additional $339.15 million available from the second installment).

13. In addition to the payments by Defendants, the amount available for distribution to qualified Class Members was increased and continues to increase by reason of the efforts and good management of Class Counsel and the Administration Team. Accruals earned on the State Treasurer's Short-Term Investment Fund are estimated to be approximately $85 million as of 1 March 2001. Thus, as of 1 March 2001, approximately $764 million ($679.15 million in principal payments to the Claims Fund plus accruals of $85 million) can be distributed to qualified Class Members from the Claims Fund less the amount distributed in the first round of refunds.

14. The 24 March 2000 Order provided that a final fee award in addition to the fee awarded in that Order would not be made unless the Court determined that qualified Class Members in the aggregate would receive substantially all of a total refund of taxes paid and a fee award in excess of the fee award of eight percent (8%) of the original $799 million common fund could be justified. As qualified Class Members will on average receive more than 110% of the taxes they paid, the threshold condition established by the Court in the 24 March 2000 Order has not only been

satisfied but greatly exceeded. Further, a final fee award is justified. The Court finds and adopts the factual statements in the 8 January 2001 Report of Class Counsel on the Status of the Settlement Common Fund as supplemented at the 19 January 2001 hearing which set out: (a) the projected payments to qualified Class Members, (b) post-Settlement administration success, and (c) post-Settlement activities which increased, preserved and protected the Settlement common fund. The Court also takes notice of and incorporates by reference the Findings of Fact in the 24 March 2000 Order.

15. An attorneys' fee up to fifteen percent (15%) of the common fund is not unreasonable. The Court, in its discretion, elects to use the percentage-of-the-fund analysis and finds that a final fee award of one percent (1%) of the initial common fund of $799 million in addition to the eight percent (8%) awarded in the 24 March 2000 Order results in a total fee which is fair and reasonable under the totality of circumstances in this litigation. The Court's award of this additional fee is based upon the post-Settlement success of Class Counsel in preserving and increasing the initial common fund, most particularly the success of Class Counsel in: (a) obtaining a favorable Internal Revenue Service letter ruling which protects Class Members from taxation on any portion of the recovery used to pay costs of administration and fees; (b) maximizing and protecting accruals to the Settlement Fund (which will be approximately $85 million); (c) obtaining a favorable ruling from the North Carolina Supreme Court which led to the accrual of interest on the Settlement Fund beginning 1 July 1998; and (d) obtaining a favorable ruling from the North Carolina Supreme Court which limited the fund to true Class Members, thereby protecting the common fund from dilution. The post-Settlement efforts of Class Counsel to protect and increase the initial common fund are completed and, therefore, the final fee award of one percent (1%) of the initial common fund should

be paid to Class Counsel immediately. In determining a final fee, the Court notes that this award provides no additional fee recovery out of the future benefit to the Class from the 100% tax exemption or the estimated $365 million in taxes already saved by qualified Class Members for tax years 1998, 1999 and 2000.

16. A final fee award of one percent (1%) together with the eight percent (8%) awarded in the 24 March 2000 Order means that:

- Qualified Class Members will receive refunds which on average exceed $4,300, a cash refund equal to more than 114% of the taxes they paid.
- Qualified Class Members will enjoy a 100% North Carolina tax exemption on their government retirement benefits for the rest of their lives.
- Qualified Class Members will receive refunds as a Class of approximately $788 million, more than 98% of the initial Settlement recovery of $799 million.
- Qualified Class Members will receive this benefit without undertaking any risk.

In return, qualified Class Members on average will forego less than $400 of the recovery to pay the attorneys who achieved this extraordinary result on their behalf. The total fees awarded are less than the accruals earned during the administration of the Settlement. If Class Members had engaged Class Counsel in a standard contingent fee case which resulted in a recovery as large as the one achieved by the Settlement, then the attorneys' fees would have been considerably greater than the total fees awarded in this case.

17. Accruals to all funds recovered for the Class have been administratively credited to the Claims Fund, including accruals on that portion of the Reserve Fund payable to Class Counsel as fees. The Claims Fund currently includes more than ten million dollars in accruals on the Reserve Fund which have been credited to the Claims Fund during the course of Settlement administration.

In the 24 March 2000 Order, the Court directed that one-half of the initial fee award be paid to Class Counsel with the remaining one-half (i.e., four percent (4%) of the $799 million common fund) payable subject only to the timing of the substantial completion of the administration of the Settlement Fund, defined in the 24 March 2000 Order as the bulk mailing of the second refund checks to Class Members. The Court, in its discretion, has determined that it is appropriate that interest be paid to Class Counsel on the four percent (4%) of the initial $799 million common fund awarded in the 24 March 2000 Order but not yet disbursed to Class Counsel. The interest should be paid from the Reserve Fund. Further, the Court has determined that the interest should accrue at the rate of eight percent (8%) per annum from 24 March 2000 until 1 April 2001 and that the fee payable but not immediately awarded in the 24 March 2000 Order, together with the interest provided herein, should be paid to Class Counsel on 2 April 2001. If the mailing of the second refund checks (warrants) to qualified Class Members occurs prior to 1 April 2001, the disbursement to Class Counsel should be permitted to be made on or after that mailing provided that no interest is paid for the period after the disbursement to Class Counsel is made. In determining the interest rate, the Court notes that an eight percent (8%) interest rate is applied to the taxes paid by qualified Class Members in determining their total Claim Amount (see below). The payment is not part of costs but rather is to be made pursuant to the common fund doctrine and from the common fund held under the direction and control of the Court.

18. The 24 March 2000 Order directed the reimbursement of "unpaid" expenses to counsel which were associated with the litigation. In addition to this reimbursement, Class Counsel are entitled to a further reimbursement of $189,230.30 for expenses appropriately incurred during the course of the litigation but which Class Counsel had credited as paid in light of costs advanced

to them by the Federal Retiree Tax Equity Task Force. Class Counsel should be reimbursed for these litigation costs in the amount of $189,230.30 provided that said amount shall in turn be reimbursed to the Federal Retiree Tax Equity Task Force.

19. After considering the amounts paid or to be paid from the Reserve Fund for attorneys' fees and expenses as well as the costs associated with the administration of the Settlement, the Court in its discretion determines that up to $24 million may be transferred from the Reserve Fund to the Claims Fund with the result that the total funds available for distribution to qualified Class Members in both rounds of refunds is approximately $788 million, of which $557 million will be available for final refunds to Class Members.

20. **Aggregate Taxes Paid Subject To Refund Calculation.** The second variable which must be quantified is the aggregate taxes paid by qualified Class Members on benefits from government retirement plans included in the Settlement. The taxes paid by each qualified Class Member for purposes of the Settlement, termed the "Overpayment Amount," is determined as set out in the Plan of Settlement Administration and other orders of the Court. See, e.g., Plan of Settlement Administration, at 29-30. Class Counsel and the Settlement Administration Organization, in conjunction with the Independent Accountant and in accordance with the Plan of Settlement Administration, have determined that the aggregate Overpayment Amount for approved and pending claims is $688.4 million in taxes paid.

21. The Class' compromise Settlement created a fixed sum certain. To accomplish a fair and efficient final distribution, the Court directed that claimants could participate in the Settlement only by making valid claims and completing other requirements established by the Court. Class Members who successfully completed all the steps necessary to establish a perfected claim as

required by the Court are entitled to receive a distribution from the Claims Fund. Failure to establish a right to a refund under the Settlement, however, does not impair the right to a tax exempt status for benefits paid by included government plans from and after tax year 1998.

22. Establishing a right to participate in distributions under the Settlement, among other things, required filing a timely claim (or showing good cause), accepting the figures provided by the Settlement Administration Organization or providing valid corrections, and timely cashing the warrant (check) issued on the claim in the first round of refunds. Class Members who do not cash a warrant from the first round of refunds within six months of the date of said warrant (or timely obtain and cash a re-issued warrant) did not perfect their claim, are not qualified Class Members, and do not have a right to a distribution under the Settlement, either from the first round or any subsequent round of refunds. Claims Fund proceeds associated with these unperfected claims will be available pro rata for distribution to qualified Class Members in the second round of refunds.

23. **Interest Rate On Taxes Paid Through Settlement Of The Litigation.** The third variable to be determined is an appropriate rate of interest, if any, to be applied. The Court has considered the total principal paid by qualified Class Members and the funds available for distribution to qualified Class Members. In light of the length of this litigation, receipt and enjoyment in the future of a 100% lifetime tax exemption by qualified Class Members, and the time-value of money, refunds should be calculated as a percentage of the principal tax paid plus interest on that principal amount. The Court's task in this regard, therefore, is to determine an appropriate interest rate and the length of time to which the interest rate will apply.

24. It is in the best interest of the Class and each Class Member that the Court select a single, uniform uncompounded interest rate applicable to the claims of all Class Members. All Class

Members are similarly situated. Many qualified Class Members are entitled to refunds for more than one tax year. The Court finds, in its discretion, that the legal rate of eight percent (8%) is an appropriate interest rate under prevailing rates in the marketplace and all circumstances of this litigation.

25. For purposes of distribution, interest shall be calculated beginning the date taxes are due, i.e., April 15 of the year following each tax year in question. For example, interest on taxes paid for tax year 1992 will be calculated from 15 April 1993. Interest shall be calculated through 30 June 1998, the time of the Settlement. The latter date is in accord with estimates used in negotiations leading to Settlement in which interest was calculated through 30 June 1998. This cutoff date is also consistent with the effective date of payment of the first installment of $400 million paid by the Defendants. Finally, a cutoff date of 30 June 1998 serves the best interests of the Class and each Class Member by giving uniform and appropriate, but not undue, weight to the time value of money (i.e., the period for which a taxpayer did not have use of his or her money). This approach follows from prior orders of the Court. The taxes paid plus interest as provided herein total approximately $880 million.

26. The Court notes that an interest rate of eight percent (8%) per annum compares favorably to interest rates in effect in the marketplace during the period in which the State of North Carolina held the money of qualified Class Members. The average interest rate according to Federal Reserve data for certificates of deposit with six-month maturity dates for the period from April 1990 (when taxes were due for tax year 1989) through 30 June 1998 was five-and-one-third percent (5-1/3%) per annum. Interest rates on passbook savings and interest checking at major banks were significantly lower than the rates for certificates of deposit. The Court also notes that the taxes paid

by most qualified Class Members are in amounts insufficient to purchase most minimum certificates of deposit available in the marketplace.

27. **Allocation Between Class Members.** The fourth variable requires the court to determine allocation of the Settlement Fund among qualified Class Members depending on whether the taxes paid were on North Carolina State or local government retirement plan benefits on the one hand or Federal retirement plan benefits on the other. The initial discount agreed to by Class Members, and approved by the Court in the Settlement, varied depending on the source of the retirement benefit. The first round of refunds to qualified Class Members took this distinction into account at a time when the final result was still unquantified.

28. At the time of the Settlement in 1998, the formal Notice of Class Action and Proposed Settlement to Class Members estimated that the Settlement Fund could pay refunds of approximately ninety-five percent (95%) of taxes paid on North Carolina State and local government retirement plan benefits (plus interest) less the fifteen percent (15%) allocated to the Reserve Fund, or 80.75% of the taxes paid (plus interest). In light of litigation uncertainties and the prospect of additional years of litigation in prosecuting claims of the Federal government retirees, the Notice estimated refunds of approximately seventy percent (70%) of taxes paid on Federal government retirement plan benefits (plus interest) less the fifteen percent (15%) allocated to the Reserve Fund, or 59.5% of the taxes paid (plus interest). The Notice also informed Class Members that:

> It is anticipated that subsequent to the initial distribution to Class Members there will be additional funds available for further distribution from various sources including, but not limited to, . . . residuals as a result of retirees who renounce their claims, who cannot be located or who fail to perfect their claims in accordance with procedures established by the Court. . . . Funds remaining after the

initial distribution to Class Members shall be allocated and distributed by Order of the Court.

Notice of Class Action and Proposed Settlement, at 5 (15 June 1998). This provision recognized that the Court, in its discretion, would allocate in an equitable manner any funds remaining after making the initial estimated payment.

29. The Independent Accountant has reported to the Court, and the Court finds, that the total funds available to pay qualified Class Members is in substantial excess of the best estimate at the time of the Settlement. It now appears to the Court that all qualified Class Members may receive refunds at a higher percentage of taxes paid plus interest than estimated for any Class Member at the time of the Settlement.

30. In light of the funds now available for distribution, it is in the best interests of the Class and of each Class Member that all qualified Class Members receive the same percentage refund of their Overpayment Amount, including interest as calculated above. The refund to each qualified Class Member in the final refund shall give appropriate credit for the refund paid to each qualified Class Member in the first round of refunds.

FIRST ROUND OF REFUNDS TO CLASS MEMBERS

31. On 26 March 1998, the Court directed Class Counsel to make a first partial distribution to qualified Class Members of: (a) forty and three-eighths percent (40.375%) of the Overpayment Amount (principal only) calculated under the Plan of Settlement Administration with respect to North Carolina State income taxes paid on benefits from included North Carolina State and local government retirement plans, and (b) twenty-nine and three-fourths percent (29.75%) of the Overpayment Amount (principal only) calculated under the Plan of Settlement Administration

with respect to North Carolina State income taxes paid on benefits from included Federal retirement plans. Order Regarding Payout to Class Members from the Settlement Fund, at 7-8 (26 March 1999). The different percentages reflected the respective initial Settlement discounts for projected refunds of taxes on Federal retirement benefits compared to taxes on North Carolina State and local government retirement benefits.

32. As of 17 January 2001, qualified Class Members have been paid a total of $231 million from the Settlement Fund in the first round of refunds.

CALCULATION OF REFUNDS TO CLASS MEMBERS

33. The Independent Accountant has calculated, and the Court finds, that refunds of taxes paid plus interest may be paid equally to all qualified Class Members at a level of approximately ninety percent (90%) of taxes paid for tax years 1989 through 1997 on included government retirement plan benefits plus interest at an uncompounded rate of eight percent (8%) per annum from April 15 following each tax year for which taxes were paid through 30 June 1998.

34. The exact calculation of the portion of each qualified Class Member's total claim to be refunded should be made by Class Counsel and the Settlement Administration Organization, in consultation with the Independent Accountant and using the most up-to-date financial information available, by dividing the total funds available for distribution to qualified Class Members (approximately $788 million) by the total claims (taxes paid plus interest) of qualified Class Members (approximately $880 million). At no time, however, should the refund calculation be made so as to result in inadequate resources in the Claims Fund to pay the second round of refunds.

35. The final round of refunds to qualified Class Members should be made at the percentage calculated and recommended by the Independent Accountant, taking into account the payment made to the respective Class Member in the first round of refunds.

36. In the Order Approving Class Action Settlement, the Court directed that "Distributions of the Settlement [now Claims] Fund to individual Class Members shall be applied first to refund the principal amount of taxes covered by the Settlement and then to interest on the principal amount." Order Approving Class Action Settlement, ¶ 4, at 9. Irrespective of the mathematical process used to allocate refunds among qualified Class Members, the refunds by filing status are properly regarded as a refund of principal until such point as the amount refunded equals the amount of taxes paid during the relevant period.

37. The precise form and timing of distributing refunds and interest to qualified Class Members is best left to Class Counsel and the Settlement Administration Organization who are in position, in conjunction with the Independent Accountant, to gauge the completeness and accuracy of the calculations. The Court recognizes that in light of the total number of valid claims, the SAO will have to print and validate approximately 185,000 warrants. Thus, the Court concludes it is appropriate and in the best interests of the Class Members that Class Counsel and the SAO be authorized to begin printing warrants as soon as practicable so that the final distributions may be made to qualified Class Members without delay.

Based on the foregoing Findings of Fact, the Court makes the following:

CONCLUSIONS OF LAW

1. Under the totality of the circumstances, a total refund of approximately ninety percent (90%) of taxes paid on benefits from included government retirement plans as defined by order of

this Court plus an additional amount equal to an uncompounded accrual of eight percent (8%) per annum from April 15 following each tax year 1989 to 1997, inclusive, through 30 June 1998, is a fair, reasonable and adequate result for the Class and each Class Member.

2. Class Members entitled to participate in the final distribution are those who timely file claims, cash refund checks (warrants), and otherwise perfect their claim as required by prior orders of the Court.

3. The common fund doctrine permits fees to be awarded not only for the creation of a common fund but also for efforts of counsel which protect or increase a common fund. In light of post-Settlement efforts which protected or increased the initial Settlement recovery, Class Counsel are entitled to a reasonable final attorneys' fee of one percent (1%) of the initial common fund of $799 million in addition to the fees awarded in the 24 March 2000 Order. The total attorneys' fees, under the totality of circumstances, are fair and reasonable.

4. The common fund is under the control and direction of the Court. Under the totality of the circumstances, Class Counsel are entitled to interest at a rate of eight percent (8%) per annum on the four percent (4%) of the $799 million common fund awarded in the 24 March 2000 Order but for which disbursement to Class Counsel has been delayed pending the mailing of the second refund checks (warrants) to Class Members. Class Counsel are entitled to interest from 24 March 2000 through 1 April 2001 or to such earlier date on which the undisbursed fees awarded by the 24 March 2000 Order are disbursed to Class Counsel.

5. Class Counsel are entitled to reimbursement of litigation expenses in the amount of $189,230.30, with the understanding that said amount be reimbursed to the Federal Retirce Tax Equity Task Force.

FOR GOOD CAUSE SHOWN, IT IS, THEREFORE, ORDERED, ADJUDGED AND DECREED THAT:

1. Class Counsel are authorized and directed to make final distribution of refunds to qualified Class Members.

2. In determining total payments from the Claims Fund to each qualified Class Member ("Overall Refund Amount"), Class Counsel and the Settlement Administration Organization, in consultation with the Independent Accountant and using the most up-to-date financial information available, shall determine the "Total Refund Percentage" applicable to all qualified Class Members. The Total Refund Percentage shall be calculated by dividing the total funds available for distribution to qualified Class Members (approximately $788 million) by the total claims (taxes plus interest) of qualified Class Members (approximately $880 million) and multiplying the resulting ratio by 100%. At no time, however, shall the refund calculation or the Total Refund Percentage result in inadequate resources in the Claims Fund to pay the second round of refunds.

3. Refunds to each qualified Class Member shall be made as follows: (a) the taxes paid by the Class Member shall be determined as provided by the Plan of Settlement Administration regarding the calculation of the Overpayment Amount (including an adjustment for the $4000 deduction available in each year taxes were paid); (b) an additional amount shall be determined by multiplying an uncompounded rate of eight percent (8%) per annum by the allowed taxes paid from April 15 of the year following the respective tax year(s) for which the allowed tax was paid, through 30 June 1998; (c) the taxes paid as determined in subsection (a) plus interest as determined in subsection (b) shall be added together to establish the "Claim Amount"; (d) the Claim Amount shall be multiplied by Total Refund Percentage to establish the "Overall Refund Amount"; and (e) the

refund paid in the first round of refunds to each qualified Class Member shall be subtracted from the Overall Refund Amount and the result shall be that Class Member's "Final Refund Amount." The amount of the check (warrant) to the qualified Class Member in the second round of refunds shall equal the Final Refund Amount. The Final Refund Amount shall be calculated by filing status to the extent practicable.

4. Class Counsel and the SAO shall take all steps necessary to void any check (warrant) from the first round of refunds not properly endorsed and cashed within six months of the date of issuance of the check (warrant). Any claimant not properly endorsing and cashing a check (warrant) resulting in payment during said period (or timely obtaining and cashing a reissued check or warrant) shall not be entitled to participate further in the distribution from the Settlement to qualified Class Members for either the first round of refunds or any subsequent round of refunds. Class Counsel and the SAO shall take the steps necessary to ensure that the claimants who did not perfect their respective claims by timely cashing the check (warrant) in the first round of refunds are not included in the list of qualified Class Members with perfected claims who are entitled to participate in the Settlement.

5. Distribution of the Settlement recovery to individual qualified Class Members shall be applied first to refund 100% of the principal amount of taxes recovered by the Settlement and only thereafter to interest on the principal amount. This calculation shall be undertaken by filing status to the extent practicable.

6. Class Counsel are awarded final attorneys' fees of one percent (1%) of the initial common fund of $799 million which shall be paid immediately to Class Counsel. This award is in addition to the fees paid or payable pursuant to the 24 March 2000 Order.

7. The four percent (4%) of the initial common fund of $799 million awarded Class Counsel in the 24 March 2000 Order but not yet disbursed shall accrue interest at eight percent (8%) per annum from 24 March 2000 through 1 April 2001 or such earlier date on which disbursement occurs consistent with the 24 March 2000 Order. If not earlier disbursed, the fees awarded by the 24 March 2000 Order but not yet disbursed, together with interest as provided herein, shall be disbursed to Class Counsel on 2 April 2001.

8. Class Counsel are awarded $189,230.30 for reimbursement of litigation expenses provided that Class Counsel shall in turn pay over this amount as reimbursement of advanced costs to the Federal Retiree Tax Equity Task Force.

9. The Treasurer of the State of North Carolina is authorized to make and shall make such transfer or transfers of up to $24 million from the Bailey Reserve Fund to the Bailey Claims Fund as required by Class Counsel to comply with this Order. Class Counsel and the Settlement Administration Organization shall undertake steps necessary for the Treasurer of the State of North Carolina to effect the transfer(s).

10. Class Counsel and the SAO are authorized to commence printing checks (warrants) as soon as practicable and, in consultation with the Independent Accountant and SAO Director Ira N. Schwarz, shall disburse individual refund checks (warrants) in their discretion at such time or times as is practicable and consistent with the terms of this Order. The disbursal date shall be the distribution date for the final refund payments.

11. Further distributions from the Settlement Fund (Claims Fund and Reserve Fund) shall be made pursuant to orders of the Court.

12. The Court retains jurisdiction over this matter for such other and further orders as might be necessary.

This the 22 day of January, 2001.

JACK A. THOMPSON
SUPERIOR COURT JUDGE

CERTIFICATE OF SERVICE

The undersigned hereby certifies that he has this day served a copy of the foregoing **ORDER DIRECTING CALCULATION OF REFUNDS, PAYMENT OF FINAL FEES AND EXPENSES, AND DISTRIBUTION OF FINAL REFUNDS TO CLASS** upon counsel for all parties as indicated below by hand delivery as follows:

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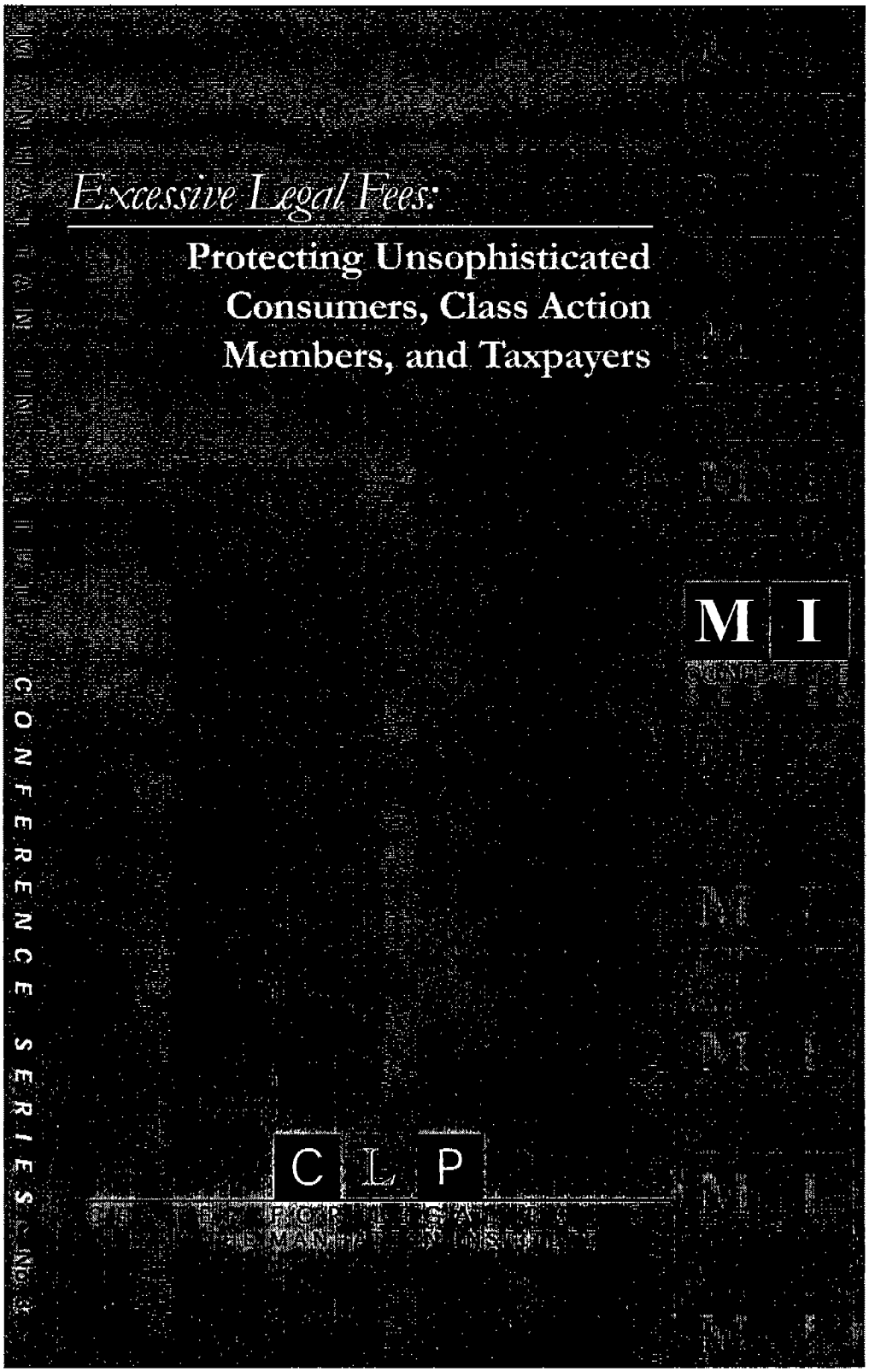
This the 22nd day of January, 2001.

Eugene Boyce

EXHIBIT F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Institute for Legal Reform

fee will not go above $Y an hour. At the end of the litigation, the client chooses which to pay, presumably selecting the lesser amount. The rule also has several features that enhance disclosure, such as an up front non binding time estimate, disclosure of fees charged in similar cases, and monthly statements of hours spent on the case.

PANEL 3: Fees in High Stakes Litigation: Class Actions and Suits by Government Agencies

The panel was opened by the Honorable Vaughn Walker, U.S. District Court, Northern District of California. Beginning with a reference to common fund cases, where attorney fee awards are predicated upon the equitable doctrine against unjust enrichment, Judge Walker noted that in America the doctrine has "been turned on its head."

> The notion here is that the *class* bringing an action should not be unjustly enriched at the expense of the lawyer. It is a rather peculiar doctrine to apply in a situation where we are attempting to come up with a reasonable way to compensate lawyers for what is essentially an entrepreneurial activity; that is, to compensate lawyers for creating some benefit to the class. It's rather like attempting to come up with a gratuity rule for good Samaritans. It does not fit the problem at hand.

Judge Walker explained the various methods for determining fees today and noted that all the methods "essentially amount to the same thing: a standardless method of determining fees." The problem, as he sees it, stems from the fact the fees are not determined in an adversarial context. Fees are determined at the end of the case, when a settlement is on the table, after the risk has passed. He concludes that an *ex ante* bidding process to determine fees in class actions promotes competition.

Professor Roger Cramton, Cornell University Law School, focused his remarks on: 1) the asymmetry in the tobacco litigation that has shifted from the defendants having an advantage to the plaintiffs having an advantage, 2) the class action as a clientless activity for

lawyers and the implications of that fact, and 3) the reality that judges are self-interested actors in the class action context whose major desire is to dispose of cases. On the last point he commented:

> Empirical studies show that over 90% of class action settlements are approved by federal courts, and an even higher percentage by state courts after so-called fairness hearings that often last 20 or 30 minutes. There are rarely any objecting parties who contest these settlements. The only information the judge has is the information given to him by the settling parties, who have no obligation to be candid about the fee allocation between the various lawyers, the deficiencies in the settlement, conflicts of interest involved, or what goes into calculating the fee. By and large, judges do not go out of their way to ask hard questions or pursue possible problems.

The next panelist, Professor Charles Silver, University of Texas Law School, maintained that "there is no rigorous empirical evidence that attorneys are frequently overpaid in private representations, class actions or state tobacco cases." He further asserted that there is some evidence that attorneys who handle class actions are often underpaid.

As to fees for contingency fee lawyers and individual representation he notes:

> Contingency fee lawyers take risks that guaranteed-hourly-rate lawyers do not take. Consequently, they earn somewhat more than those lawyers. That means the market is working the way it should. We should not expect to see them earning exactly what other lawyers earn because they're not delivering the exact same services that other lawyers are delivering.

He sees class action lawyers under-compensated, however:

> The most significant problem we have in class action litigation today is not over, but under-compensation of lawyers,

> as well as a failure to tie lawyers' compensation to the risks that they incur in these cases. Why do we have this problem? Because everybody thinks about fees in terms of legal ethics. Fees in class actions have nothing to do with legal ethics and are not governed by ethical principles. Class actions are about due process of law, not legal ethics.

Professor Silver believes that fees in class actions should be used to encourage lawyers to maximize the recoveries of class members. "If it turns out that you have to pay the lawyer $100,000 an hour to overcome risk aversion, do it. That's what due process requires." He further maintains that judges routinely ignore state bar ethics rules when managing class actions because they too believe class actions are not about ethics but about due process.

The next panelist, Michael Horowitz, Director of the Project for Civil Justice Reform at the Hudson Institute, countered Professor Silver's remarks by describing the fee debate as one where there is "the rhetoric of ethical regulation and fiduciary duty, and the reality, thanks in part to Charlie's efforts, to an almost complete (and increasing) real-world breakdown of enforceable ethical norms. We have busy judges who don't want to get involved in fee regulation and who find it easier, as Roger Cramton has pointed out, to award or endorse flat percentage fees. In the case of attorneys' fees, we have thus moved away from any semblance of regulation into the brave new unregulated world that Charlie posits."

The next panelist, Robert Peck, Senior Director of Legal Affairs, Association of Trial Lawyers of America, asserted that the majority of ATLA members do not make what a first year associate makes in a Washington DC law firm, but make less than $100,000 a year. He maintained that although many members charge less, the typical contingency fee is 33% and represents a market rate that considers the compensation due an attorney, the contingent nature of the litigation, the investment made by the attorney by advancing costs, the inherent risk of non-payment or underpayment, the quality of the attorney's work and the result achieved.

As to fees in class action cases, he disagrees with Professor Silver and asserts that courts have increasingly been exercising their authority to police fees.

The final panelist, Boyden Gray, Wilmer, Cutler & Pickering, hailed the virtues of Judge Walker's fee auction innovation indicating that the LIABA did a study called "Turning the Tables", which looked at the results of auctioning off lead class roles. "The article and the study upon which it is based showed that auctions tend to bring the contingency fee down to 7%. This is a two-thirds reduction from the sort of ordinary 20% that I think one gets in the big cases—not thirty three: it's really probably more like 20–21%."

whether or not class counsel behaved competently and ethically during proceedings. Members of the class, if they did not opt out, should have a right to bring separate malpractice actions.

If these changes were made, Bill Lerach and his firm might have to purchase malpractice insurance. One interesting aside—maybe it's some poetic justice—when Fischel and Lexicon hit the Milberg Weiss firm with a third party action potentially worth hundreds of millions of dollars in damages, Milberg Weiss settled for $50 million. It turned out they had no malpractice insurance. They believed Bill Lerach's logic and thought, "We have no clients." Therefore, we don't need malpractice insurance. The firm members had to cough up the $50 million.

PROFESSOR CHARLES SILVER: I've decided to use multimedia and to give you something to look at.

I'm going to advance two arguments in my talk, which is entitled "Much Ado About What? Where is the Evidence of Excessive Attorney Compensation?" First, there is no rigorous empirical evidence that attorneys are frequently overpaid in private representations, class actions or state tobacco cases. Second, there is some evidence that attorneys who handle class actions often are underpaid. They're paid too little, despite the fact that they're earning millions and billions of dollars. I do not expect this to be a popular position to take in front of this audience.

One of the things that has bothered me about most of the debate here so far is that it's theory deprived. Nobody has started out by telling you what you would expect to see in the way of attorneys' fees in a perfectly competitive market.

In labor market equilibrium, we would expect to see that differences in the level of compensation for service providers would reflect real differences in those service providers' contributions. That is, real differences in the costs they're bearing, in the skills they're bringing to the task, and in the risks that they're taking.

Why is it that we expect differences in compensation to reflect differences in levels of service? Because if there were excessive compensation available, then other service providers would have an incentive to enter those practice areas and compete away the profits being made in the form of excess compensation. If we have freedom of access to the legal markets and freedom of movement laterally among the specific practice areas of the legal market, we should not expect to see significant profits being collected. These stipulations beg the question: are there barriers to entry to the legal market? There used to be. In the grand old days of legal ethics there used to be many barriers to entry. But guess what? There aren't anymore.

I have two quotations for you. The first is from Richard Abel's *The Transformation of the American Legal Profession*: "The entry barriers that lawyers painfully constructed over half a century have failed to withstand the assaults by the growing numbers aspiring to become lawyers. This should not be surprising. Supply control in a capitalist economy can never be more than temporary. Its very success engenders more vigorous attacks."[25]

In the second quotation, Robert Nelson and David Truebeck say roughly the same thing, but you don't need to read them. Just remember Dan Quayle. There are too many lawyers in this country. America has 70% of the world's attorneys and we're getting close to the one million-lawyer mark. It is not possible for the bar to have swelled to such a size and still maintain that there are significant barriers to entry into the legal profession.

There is a growing population of lawyers that, in my opinion, reflects the growth of our economy. If you don't believe me, take a look at my article in the current Yale Law Journal entitled, *What's Not to Like About Being a Lawyer*.[26] It contains cites and data about the positive correlation between economic growth and the growth of the legal profession, both in this country and others.

What has happened as a result of the demise of barriers? The answer is exactly what you would expect in a competitive market:

the prices of legal services and lawyers' salaries have fallen. A quotation from Sander and Williams supports this contention: "From 1970 to 1985 the price of legal services fell by 10%. From 1972 to '82, partner income fell 15%, and incomes of sole proprietors fell a remarkable 46%."[27] Richard Posner, that noted liberal, explains another result of lawyer proliferation: "The increase in competition that has occurred since the 1960's has forced lawyers to serve their clients better and so to rely less on mystique and more on specialized knowledge that has general value to the client."[28]

What's happened in the legal sector is exactly what one would expect to see in a competitive market when barriers to entry are reduced. Supply goes up, price goes down, and quality of service improves as lawyers compete with one another aggressively for business. As a result, we also see that contingent fee lawyers rarely receive windfalls. Studies have shown that the returns earned by contingent fee lawyers are not much out of line with the returns earned by lawyers who work on a guaranteed compensation basis.

Herbert Kritzer studied 511 Wisconsin contingent fee lawyers for a 1997 article.[29] What did he find? Lawyers' fees from contingency fee work do not differ substantially from the median rate charged for hourly fee work. That's exactly what we would expect to see, because if it were possible to make buckets of money being a plaintiff's attorney without taking any risk, all of the securities, income tax, and trust and estates lawyers would enter the contingency fee market.

Stock and Wise conducted a different empirical study. They looked at data collected on ordinary contingent fee representations in a variety of different jurisdictions. What did they find? Compared to non-contingent cases, the estimated risk premium for cases taken on contingency is about 16%.

What we're seeing is exactly what we would expect to see in a competitive market. Contingency fee lawyers take risks that guaranteed-hourly-rate lawyers do not take. Consequently, they earn

somewhat more than those lawyers. That means the market is working the way it should. We should not expect to see them earning exactly what other lawyers earn because they're not delivering the exact same services that other lawyers are delivering. But enough about contingency fee lawyers and individual representation. What about contingency fees and class actions?

A lot of gross exaggeration has taken place here about what the fees are in class actions. Most class actions are very small. They settle for a couple of million dollars and the fees tend to be a half a million dollars or less. What we would really like to know is why class actions are like that. Why is it that so many class actions settle for small sums?[30]

One possible reason is that fees are too small to justify the risk that lawyers would incur to take large cases and prosecute them successfully. That's not just my opinion, it's also the opinion of Stock and Wise. Who are Stock and Wise? They are professors at the Kennedy School of Government who are trained economists. They published a piece in *Class Action Reports* in which they apply an economic model that looks at something called risk aversion.[31]

Risk aversion is something that you haven't heard anyone talk about on this panel. That's because in individual plaintiff representations, risk aversion really isn't a problem. Lawyers who handle personal injury cases have diversified portfolios. They're like stockholders. They have lots of shares in lots of different companies, so they have a predictable rate of return on their portfolios.

Class action lawyers aren't like that. They have a relatively small number of cases, each of which represents a very large non-diversifiable risk. They are incredibly risk averse. Now, the rational thing for a risk averse person to do when faced with large risks is to settle cheaply unless highly motivated to do otherwise.

Stock and Wise say, "Multipliers would have to be substantially higher than recent court-awarded multipliers to induce firms to

take on larger cases with lower success probability." As it is today, class action lawyers will take on cases where the likelihood of recovery is at least 70 to 80%. They then settle those cases or sell them out cheaply because they're not incentivized to take the risks that would be required to make something of them. They're not even going to take cases that have a 50% likelihood to win because the payoff does not warrant it.

The most significant problem we have in class action litigation today is not over, but under-compensation of lawyers, as well as a failure to tie lawyers' compensation to the risks that they incur in these cases. Why do we have this problem? Because everybody thinks about fees in class actions in the wrong way. Everybody thinks about fees in class actions in terms of legal ethics. Fees in class actions have nothing to do with legal ethics and are not governed by ethical principles. Class actions are about due process of law, not legal ethics. The purpose of the class action is to insure that a person who has not actually appeared in court is bound only when he or she is adequately represented.

Accordingly, the manner of regulating fees in class actions should be calculated with an eye to insuring that every class member is adequately represented. What does that mean? It means we should regulate the fee in a way that encourages lawyers to maximize the absent class members' net recovery. If it turns out that you have to pay the lawyer $100,000 an hour to overcome risk aversion, do it. That's what due process requires.

If such a fee is inconsistent with the state bar ethics rules that limit fees to a reasonable amount, I say too bad for them. Judges routinely—I emphasize routinely—ignore state bar ethics rules when managing class actions because they understand that class actions are not about state bar ethics rules. They're about due process.

Every state in the country has something called the aggregate settlement rule. But no judge presiding over a class action has ever applied it to a class action settlement. Why? Because the aggregate

settlement rule allows a group lawsuit to settle only with the unanimous consent of every client who participates. Can you imagine the difficulty of getting every class member to consent to a class-wide settlement? It would never happen. If we're going to have class action settlements at all, we can't apply that rule. So judges don't. Judges also ignore the duty of loyalty rules in class actions. They allow lawyers to do all kinds of things in class actions that lawyers representing individual clients would not get to do. They also ignore the duty of obedience.

My point is simple. Judges should also ignore the fee rules. They should set fees in class actions with an eye to maximizing the net recovery of class members and they should not care one whit about the criteria that state bars have adopted. I explain all of this at much greater length in a forthcoming article in the *Tulane Law Review* and I have explained it in other writings I have already published on class actions.[32]

Why are fees in class actions so controversial if, as I believe, they are too low? It's because when fees in class actions are handled as they should be, in a manner that's calculated to maximize the value of the claims, defendants get upset. The defendants are the people who are here today. You, the defendants, don't want fees in class actions to be handled in a manner that maximizes the value of class actions. You, the defendants, want fees in class actions to be handled in a way that minimizes the value of class actions. So you complain when judges try to tie the fees to the recovery. That's one reason that fees are controversial.

By the way, it really vexes me that people keep blaming plaintiffs' attorneys for the reversions that we see in class action settlements. I do not know a single plaintiffs' attorney who has ever proposed that unclaimed funds in a class action should revert to a defendant. Defendants always insist on that. If defendants were willing to give up on reversions, which everybody including me regards as terrible, reversions would disappear tomorrow. I don't know why plaintiffs' attorneys are being blamed for this feature of settlements.

Why else are class action fees controversial? Defendants don't like these fees, so they underwrite tort reform movements. The tort reform movements spend lots of money getting abuses of fees into the media, and certainly there are lots of fee abuses in lots of different cases. All the statistics that I've talked about are aggregate statistics.

The American legal system is huge. If you look hard enough, you'll find all kinds of things to complain about, and defendants and tort reformers have created a mechanism that gets distorted cases into the media and keeps ordinary cases out. I offer as an example the case of the grandmother who spilled hot coffee into her lap at a McDonald's. Everybody's heard of it.

Why have you heard of the McDonald's case? Because millions of dollars were spent to make sure that you did. But the McDonald's case is just one case out of a zillion. Its importance is minuscule, and I'm sure that what you heard about it was totally incorrect. What we have is a one-sided media affair.

Finally, I want to address the tendency to think about fees in class actions in ethical terms instead of due process terms. Let's consider the tobacco cases.

I have a simple thesis. There's nothing wrong with the fees that were promised in the tobacco cases. Why? For every reason that I can think of. First, the contracts were made by sophisticated clients who were themselves represented by lawyers. Second, the market provided opportunities for the attorneys general to shop for the lowest possible rates. In Texas, I know for a fact that the attorney general hung out a "help wanted" sign and for a long time could not get any lawyers to take the case.

Moreover, tobacco case fees varied with market conditions. Lester Brickman has studied the fees that were offered by the states. I think he will agree with me that, generally speaking, the fees declined over the course of the litigation. As it became clearer that

there might be sizable recoveries, the fees declined—which is what you would expect to see in a competitive market. The private attorneys involved took exceptional risks. Remember, they were asked to finance millions of dollars out of their own pockets. That's incredible, given the size of the firms involved. Start throwing in risk aversion, because these are non-diversifiable risks, and the fees have to go up astronomically.

My favorite point, though, is this. When the attorneys general announced these contracts back in the early or mid-1990's, nobody complained. I was there in Texas in 1996 when our attorney general, Dan Morales, announced our contract. It said 15% of the recovery would go to the lawyers. You don't win anything, you don't get paid. Did Governor George W. Bush jump in and say, "Hey, that's excessive?" No. He said, "I leave this decision to my attorney general." What did John Cornyn, our current attorney general, say at the time? Not one word. What did the seven state legislators who subsequently intervened in the case to attack the payment of the fees say at the time? Nothing. They were all in hiding.

Why is it that nobody complained back in 1996 when our contract was announced and it was publicized that 15% of the state's recovery, which was then thought to be around $400 million, was excessive? Because it wasn't unreasonable and because they were cowards. Our detractors knew they couldn't stand up to object without appearing to be in the lap of the tobacco industry.

A lot of this, I think, is politically motivated. Why is it politically motivated? Trial lawyers support Democrats. No kidding.

Here's an article from *The Dallas Morning News* this week. "Trial lawyers give heavily to Democrats. Tobacco attorneys among biggest donors." It basically says the tobacco lawyers in Texas are Governor Bush's worst nightmare. And they are. My take on this is very simple. It's their money. Let them do whatever they want with it. They can give it all to charity; they can spend it on jets; they can give it to Democrats. I don't really care. That's not a matter of legal ethics at all.

Now, there are other reasons why the attorney fees in the tobacco cases are controversial. One of them is legitimate. The controversy over tobacco fees raises legitimate concerns about excessive governmental power, but this is miscast as a concern about the ethics of contingent fees. I'll read you a quote. "Businesses have undertaken a campaign to prevent states from retaining private attorneys on a contingent fee basis, the compensation arrangement that enabled the attorneys general to bring the tobacco companies to their knees. At stake in this epic struggle is nothing less than the balance of power between the private and public sectors."

That, it seems to me, is the legitimate issue at stake in the tobacco cases. How much power are the states going to have to exert over private businesses? If they have access to contingent fees, they have tremendous power. If they don't, then their power is considerably less. Who am I quoting? I'm quoting myself. There is a legitimate issue here. I am as anti-regulation and as fearful of government power as any person sitting in this room. I guarantee you, given the positions I've taken in public, that if Governor Bush becomes President, I will be more fearful of public power than any of you. But you know what? Fear of public power is not a good reason for not paying these lawyers.

Why is that? Because governments do all kinds of things that they should not do, including things that are dumb and things that are clear abuses of power. There are many projects that might be better left to the private sector: school finance, garbage collection, public transportation, collection of child support, insurance for bank deposits and retirement funds. There also are many public projects that are misguided, especially the war on drugs.

That said, I think that anyone who contracts with a government to provide a service in connection with any one of these projects is entitled to be paid the contract rate. The fact that the government is doing something that's stupid or excessive is not a reason for breaching a contract with a private service provider. Teachers, military contractors, all who make contracts with government are en-

titled to be paid the contract rate. They do not deserve to have ethics professors or politicians carping about their fees after they have done what they agreed to do.

MR. BARNES: We now move to the Washington, D.C. wing of the panel, beginning with Michael Horowitz, who many of you know is the senior fellow and director of the Project for Civil Justice Reform at the Hudson Institute.

MR. MICHAEL HOROWITZ: I agree with the core of what Charlie Silver has said. With him, I strongly believe that legal fees should be based on a clear and fair relation between risk and reward. Charlie and I part company, however, when he claims that this can be done by letting the devil take the hindmost, by treating lawyers as businessmen and by treating clients as if they were simply commercial customers, by doing nothing but enforcing fee agreements as written by lawyers and signed by their clients. Charlie would trash the rules in existence, operative legal ethics codes that require fees to be reasonable ones, and would openly abolish the present fiduciary basis of the attorney-client fee relationship. (He would do so by simply not enforcing presently governing rules without repealing or amending them. But, let's pass by the ethics and propriety of his "if-you-don't-like-a-rule-let's-simply-ignore-it" jurisprudence in the interest of debating the virtues and value of his arguments about fiduciary rules and standards.)

In making his case, Charlie offers a supposed analogy between attorneys and insurance companies. As he points out, insurance companies have large pools of clients, some of whom are young, healthy and unlikely to get sick or die, from whose premiums large profits can be expected to be made. But what Charlie doesn't mention is that insurance companies are obliged by a complex set of generally enforced laws and regulations to balance those profits against the losses likely to be incurred by insurers' obligations to offer insurance to riskier customer cohorts. What he neglects to mention is that the insurance business is a highly regulated one, where high rates of return generally lead to State-mandated rate reductions.

It's not "self-regulated" by bar association ethics . . . rhetoric enforced, if at all, only against a small handful of small-fry lawyers.

What we have, as Lester Brickman has made clear, is a situation where there is but the rhetoric of ethical regulation and fiduciary duty, and the reality, thanks in part to Charlie's efforts, to an almost-complete (and increasing) real-world breakdown of enforceable ethical norms. We have busy judges who don't want to get involved in fee regulation and who find it easier, as Roger Cramton has pointed out, to award or endorse flat percentage fees. In the case of attorneys' fees, we have thus moved away from any semblance of regulation into the brave new unregulated world that Charlie posits.

Charlie thinks this world a swell one because he thinks that abandoning attorney-client fiduciary standards creates a better risk/reward relationship for both attorneys and clients in mass tort cases, creates a fairer balance between the work done by attorneys and the compensation they receive. This world will be in even fairer balance, he says, once mass-tort contingency fees get even higher.

My difference with Charlie pivots on the issue of whether, in the real world of today's mass tort cases, there is often even the slightest relationship between the risks that increasing numbers of attorneys bear and the rewards they are increasingly receiving.

In making his case, Charlie highlights the McDonald's case. It's good advocacy for him to do so, for the hot coffee spill case was one in which, against great odds, a lawyer took on a brutally risky case and won. For that reason, I think it a strategic mistake for the business community—and for Fred Barnes—to present the McDonald's case as a paradigm of runaway tort law.

I may believe that the lady burned by the coffee shouldn't have won her case. But I also know that her lawyer took on substantial risk and deserved to be well compensated for his success—and I've got no beef with the standard percentage fee he received. On the other hand, I'd like to talk about the cases Charlie ignores—for example

the paradigm claim of a patient whose wrong leg has been sawed off by a drunken surgeon. Today, when such a wronged, afflicted victim hobbles into a lawyer's office, the lucky lawyer can expect to become a multi-millionaire at no risk to himself. His payoff will indeed be handsome enough to allow him to refer the case to another lawyer who will do the work and with whom he can split his fee and still make his million. As distinguished from Charlie's insurance companies, lawyers today increasingly revel in such a world—one in which (as distinguished from insurance companies) they and they alone decide what cases to take and what fees to charge. Mass tort case lawyers now increasingly exploit the bar's monopoly of access to the courts to mulct clients of millions and now billions of dollars, doing so "in exchange" for assuming few if any risks and while adding little and often negative value to their clients' claims.

Which brings us to the tobacco cases, a Teapot Dome scandal that puts Charlie's theories of risk/reward ratios in mass tort cases to real world test. In my view, the cases are a terrifying harbinger of what's coming, and pose the largest single strategic threat to the well-being of America's 21st Century legal, commercial and political systems. Here's the record: Many lawyers in the recently settled tobacco cases will earn hundreds of millions and *billions* of dollars in fees for no-risk, copycat, late-filed representations, and even the lawyers who first brought the cases and assumed real risks of non-payment when they did so are scheduled to receive fees far in excess of any imaginable fiduciary standard and far in excess of what they needed to hope for as a *quid pro quo* for the representational risks they assumed.

Let's look at but a mere sample of the seamy record of the tobacco fee awards that Charlie Silver purports to defend. In Maryland, Peter Angelos now seeks a $1.1 billion fee for a case described by the President of the Maryland State Senate (who thinks Angelos should get a mere $500 million fee) as one in which the legislature—and I quote—"changed centuries of years of precedents to guarantee [him] a win." Angelos, by the way, is the largest single contributor to the Maryland Democratic party and is a controlling,

if not *the* controlling figure in Maryland politics today. This is the man who wants 1,100 million dollar bills, taken from the taxpayers of the State of Maryland, for a case that he couldn't lose.

In the Florida tobacco case, the lawyers have been awarded a $3.43 billion fee. What's a billion dollars, as Everett Dirkson used to say, except that, in time, a billion dollars here and there starts to add up. In the Florida $3.43 billion case, the lawyers were retained after the legislature changed the laws of the State to create, in the words of the statute's author, a "slam dunk case that couldn't be lost."

On and on the tobacco fee scandal goes, with multi-million and billion dollar payoffs to politically wired Democratic and Republican attorneys. We are looking at $500 million a year in fees scheduled to be paid to 300 lawyers more or less—that's probably on the high side—*for the next 10,000 years!!!* We are looking at $300,000, $400,000 per hour fees in zero risk cases, and that is the nature of a rotten Teapot Dome scandal that will give a handful of lawyers sufficient capital to, as they say, "invest" in and significantly control state judicial elections and entire political systems well into the 21st Century.

In one of the cases Judge Walker cited, the court stated the obvious: that a $100 million case was not ten times harder for a lawyer to conduct than a $10 million case, and that it was therefore wrong (and unfair to his client) to permit a contingency fee ten times larger in the $100 million case and that it was equally unnecessary to do so in order to insure effective representation in future cases of that sort.

To get closer to home, let me ask whether a $250 billion case is a thousand times harder for a lawyer than a $250 million case? Of course not. The kind of compensation we're looking at from multi-billion dollar cases is creating a new class of billionaire lawyers—forty, fifty, or sixty of whom will be in the Forbes 400 in the next ten to 15 years unless we enforce fiduciary standards when dealing with fees in mass tort cases.

The ironic thing is that a $250 billion case is not 2500 times harder for a lawyer than a "mere" $100 million dollar case—all things being even close to equal, it is in fact *less* risky to take on and easier to win. The reason for this is nicely captured by Judge Posner in the *Rhone-Poulenc* case.[33] This was a case where the District judge had certified as a class action a series of claims brought by a highly sympathetic group of class plaintiffs, hemophiliacs with AIDS who had sued companies that had provided transfused blood.

Noting that all of the plaintiffs had been aggregated into a single case, Judge Posner did a simple calculation. He found that the potential liability in that one case was greater than the net worth of all of the defendants combined. As such, he then rightly found that the class action certification required the defendants, as the price of playing the game of law, to bet themselves. Judge Posner thus found that to certify the cases into a single class litigation—a "merely" procedural decision—was the functional equivalent of a decision on the merits rendered against the defendants.

A defendant faced with a single case which, if lost, terminates its existence, is in the same position as a man confronted with a gun to his head and asked for his wallet. In such a situation, the most prudent course is to bargain for a share of your billfold. It's imprudent to risk the life of a company on a single case, and the legal merits of a defendant company's position will matter less and less in determining whether a defendant will thus be obliged to surrender to mass tort claims made against it. In such cases, the defendants' lawyers will engage in a Kabuki to skinny down the size of the ransom that their client pays. And, this will be increasingly truer as tort lawyers, flush with tobacco and other mass tort case fees, have billions to "invest" in elections of state judges.

Imagine yourself the general counsel of McDonald's, or the general counsel of Exxon a few years from now. Imagine there are floods on the East Coast and droughts in the Midwest. Imagine then that the Midwestern farmers and the East Coast beach house owners are suing the oil companies for the value of their proper-

ties. Imagine that they are joined in their claims by state attorneys general and other public officials alleging billions of dollars of lost tax revenues caused by alleged global warming caused by hydrocarbon fuels. Imagine further that your files have memos speculating on the relation between automobile fuels and higher temperatures. Finally imagine that ten to fifteen state supreme courts are dominated by tort lawyers as a result of the elections of, and election campaigns financed by, billionaire attorneys. (I think the ten-fifteen speculation modest, given the likely effect of multi-million dollar lawyer investments in state judicial elections.) As Exxon general counsel, what are your alternatives?

Or, let's say you're the general counsel of McDonald's and are being hit by lawsuits based on the high cholesterol content of hamburgers brought both by states and medically impaired customers. Leave aside that legislatures have refused to bar the sale of Happy Meals. Forget that you tried to introduce low fat hamburgers, and that consumers refused to buy them. The simple fact of the matter is that you've almost got to be crazy to defend yourself to judgment against such suits, irrespective of the merits of your defenses. (Among other things, your stocks will be phenomenally depressed for as long as the cases go on.) In the end, your job as general counsel of McDonald's will be twofold: first, make sure that competitors like Kentucky Fried Chicken are also defendants, and next try to reduce the amount of the settlement so that the tort/excise tax on every hamburger eaten is not 25 cents but 15. You will work to ensure that the global warming case only adds 15 rather than 20 cents to each gallon of gas—or 75 cents rather than a dollar to every pint of booze or $25 rather than $50 to every pistol price tag. What is the best way to do that? Easy. Work with the guys who control the litigation, the thousand or so lawyers who are colluding with state attorneys general seeking free revenue windfalls that come into state coffers without anyone ever having to vote for a controversial tax increase. As defense attorney here's what you do: give the lawyers six rather than three cents on every hamburger eaten from now till the end of time, three or four cents per gallon of gas rather than a mere penny, five rather than two dollars per pistol.

You get the point. Do that and you'll get your settlement, with only 15 cents added to the price of hamburgers.

Now, where is Congress, where are the state legislatures, in all this business? Nowhere. What of taxation without representation principles, of constitutional provisions vesting legislatures with the power to tax? Again no place. These sorts of cases will corrupt our system, and corrupt it more fundamentally than is commonly supposed. And they will produce tens of billions in unethical fees in straight-out blackmail cases whose legal merits and/or lack thereof will be of increasingly marginal significance.

MR. ROBERT PECK: This has been a very entertaining day for me. I've witnessed leaps of logic and heard factual predicates that can only exist in a world of computer-generated animation, where dinosaurs come alive and take on human qualities. So we've achieved at a bargain price, on this panel, what it took more than $200 million for Disney to do in it's movie *Dinosaur.*

Earlier panelists have described studies I have read as though they say something entirely different from the reports' express words. The ATLA web site has also been scrutinized, and the news headlines reprinted on the site have been portrayed as reflections of our policy. I've heard our convention, which is scheduled from July 29 to August 3, moved by one speaker to sometime in June. I've heard celebration over the fact that ATLA lawyers did not sue over Y2K because of Chamber supported legislation, yet that legislation exempted personal injury claims from it's coverage, which, of course, is what our lawyers sue about. Instead, I would have expected embarrassment. The lack of problems or litigation exposes the hoax that there was a Y2K litigation crisis. Even in the Third World countries where they did not spend money to fix the alleged problems, there did not seem to be any problems.

And I've heard a New American Rule announced, a Rule where sophisticated clients—i.e., the clients that are members of the Chamber—are exempted. It exists only for consumers who actu-